Financial Interests of European Scale FIES

Assessing the Effectiveness of Preventive Administrative Approach

Daniele Senzani

Editoriale Scientifica

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Chapter 6. A possible new frame to protect the *Financial Interest of European Scale*. Some proposals on administrative preventive measures. *(Daniele Senzani)*

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[45].

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

[45] SENZANI D. (2019), *Misure di prevenzione della corruzione, discrezionalità e prassi amministrativa, in Coll. Ed., Legislazione Anticorruzione e Responsabilità nella Pubblica Amministrazione,* Giuffré Francis Lefebvre.

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[46].

[46] Eurpean Commission, *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.

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.

Chapter 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.

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

ECJ: European Court of Justice

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

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