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Joint Initiative for improving access to funding for European Union Young Farmers

DISCLAIMER

This publication describes a new joint European Commission Directorate General for Agriculture and Rural Development (DG AGRI) – European Investment Bank Group (EIB Group) Initiative for young farmers in the EU. It builds on the possibilities for achieving high impact of using both the European Agricultural Fund for Rural Development (EAFRD) and EIB Group funding, fund management and advisory support with a single major objective – to support the generational renewal of EU farming.

Glossary and definitions

Expression	Explanation
AS	Advisory Services
CAP	Common Agricultural Policy
CPR	Common Provisions Regulation
EAFRD	European Agricultural Fund for Rural Development
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
EIF	European Investment Fund
GGE	Gross Grant equivalent
MBIL	Multiple Beneficiary Intermediated Loans
MFF	Multiannual Financial Framework
RDP	Rural Development Programme
SMEs	Small and medium-sized enterprises

FOREWORD

The agriculture and bio-economy[1] sector is one of the EU's largest economic sectors, with an annual turnover of around EUR 2 trillion and employing 18 million people, or 8% of the total EU workforce[2]. It is a key contributor to economic growth in the rural and coastal regions, representing about 4.2% of the EU's GDP[3]. Yet, the majority of operators in the sector - farmers, small and medium enterprises, mid-caps and cooperatives - remain largely underserved in terms of access to finance. This was confirmed again recently by a *fi-compass* survey[4] of around 7 600 farmers in twenty four of the Member States.

As European Commissioner for Agriculture and Rural Development and as Vice-President of the European Investment Bank (EIB), we recognise the importance of investing in the long-term future of farming communities. We need farmers to continue producing high quality, affordable food in an environmentally sustainable manner for EU citizens, and contributing to solid economic growth. 'Generation renewal' is not alone the catch-phrase driving the collective efforts of our new initiative, but it is the key to keeping Europe's countryside and rural communities alive and thriving.

The European Commission and the EIB are now joining forces to address this financing gap with a package of funding and advisory tools targeting young farmers. This technical guide is aimed at raising awareness of these tools amongst EAFRD managing authorities, who have a key role to play in this important initiative to strengthen support for the young farmers in their respective regions and communities. We are particularly pleased about the potential that this coordinated support package provides in assisting Member States and regions to advance with the use of financial instruments, together with grants, technical assistance and additional financing from the EIB Group.

As part of this package, we are pleased to announce that the EIB has put in place a EUR 1bn programme loan facility, to provide long-term affordable financing through financial intermediaries, to SMEs (including farmers) active in agriculture and bio-economy value chains. The package includes a dedicated window through which young farmers will be prioritised. It will incorporate extra incentives, where market conditions allow, to increase the allocation to this special target group. Together with the co-financing of the financial intermediaries, it is expected to mobilise around EUR 2bn of long-term financing for the sector across the EU.

To improve the attractiveness of this financing, we want managing authorities to use their EAFRD resources to increase the package of funding available, and potentially making it even more attractive for farmers, through the use of financial instruments, like guarantees, that may lower the pricing and collateral requirements of lenders.

Specialised advisory expertise and additional resources from the EIB Group are also being made available to support the initiative and work with a pilot group of managing authorities looking to test new financial instrument and blending ideas, both in the current programming period and the next.

You are all very welcome to discover the detail of this package of support presented in this latest publication from *fi-compass – the Commission funded advisory platform for financial instruments funded from the European Structural and Investment Funds*.

1 The bioeconomy covers all sectors and systems that rely on biological resources – animals, plants, micro-organisms and derived biomass, including organic waste – as well as their up and downstream value chains. It includes and interlinks: land and marine ecosystems and the services they provide; all primary production sectors that use and produce biological resources (agriculture, forestry, fisheries and aquaculture); and all economic and industrial sectors that use biological resources and processes to produce food, feed, bio-based products, energy and services (cf. European Commission, Bioeconomy: the European way to use our natural resources, Action Plan 2018 is accessible here: https://ec.europa.eu/research/bioeconomy/pdf/ec_bioeconomy_booklet_2018.pdf).

2 European Commission, Bioeconomy Action Plan, 2018.

3 Ibid.

4 *fi-compass* report outlining the main results of the survey: "Survey on financial needs of EU agricultural enterprises".

We would like to conclude by congratulating everyone involved in bringing this new package to fruition. Impacts from such collaborative success can make a real long-term difference throughout rural Europe and we expect that Member States will make good use of these new opportunities. May this guide be a first step in bridging the market failures in order to support the next generation of European farmers that will help secure Europe's sustainable food, biomaterials, bioeconomy supply and rural communities for years to come.

Phil Hogan
Commissioner for Agriculture
and Rural Development
European Commission

Andrew McDowell
Vice-President
European Investment Bank

Table of Contents

Glossary and definitions **2**

INTRODUCTION **7**

1. YOUNG FARMERS' ACCESS TO FINANCE NEEDS **10**

2. THE BENEFITS FROM USING EAFRD FINANCIAL INSTRUMENTS **13**

3. EIB GROUP SUPPORT FOR MANAGING AUTHORITIES, FINANCIAL INTERMEDIARIES AND YOUNG FARMERS **16**

EIB Group loans 16

EIB Group risk sharing instruments and guarantees 17

EIB Group advisory support and fund management 17

4. ADDITIONAL COMBINATION POSSIBILITIES **18**

ANNEX I – FINANCIAL INSTRUMENTS FOR YOUNG FARMERS **20**

Option A: Start-up support for young farmers – Funded Risk Sharing Loan 20

Option B: Start-up support for young farmers – Guarantee instrument 22

Comparison: Use, advantages/disadvantages of the two instruments 24

ANNEX II – EXAMPLES OF COMBINING FINANCIAL INSTRUMENTS WITH TECHNICAL ASSISTANCE/TECHNICAL SUPPORT AND OTHER GRANT FUNDED COMPONENTS **26**

Example 1 – Guarantee instrument including technical support and cash grant 26

Example 2 – Guarantee instrument including repayment bonus option 27

Example 3 – Loan instrument including technical support 29

ANNEX III – GUARANTEE INSTRUMENTS COMBINING EAFRD WITH EFSI **30**

List of figures

Figure 1: Potential combination options of EAFRD grants and financial instruments with EIB Group lending, fund management and advisory services 8

Figure 3: Results of the application of farmers for bank finance 11

Figure 4: Key reasons why banks refuse the loan applications of farmers (multiple responses allowed) 11

Figure 5: Example of a delivery model for EAFRD financial instrument for young farmers using support under Measure 6.1 15

Figure 6: EIB Multiple Beneficiary Intermediated Loans (MBILs) 16

Figure 7: EIB Group guarantee product 17

Figure 8: Illustration of how a Funded Risk Sharing Loan works 20

Figure 9: Impact of the guarantee on the interest rate 22

Figure 10: Loss-sharing at loan level 23

Figure 11: Risk Sharing at portfolio level 23

Figure 12: Potential impact of the combination of EFSI resources in an uncapped guarantee instrument 30

INTRODUCTION

The purpose of this publication is to raise awareness amongst EAFRD managing authorities of the possibilities to strengthen their support for young farmers in their respective countries and regions. The proposed joint DG AGRI - EIB Group initiative presents further possibilities to get access to and potentially better combine EAFRD grants, EAFRD financial instruments and EIB Group advisory, fund management and lending activity, into a more comprehensive support package for EU young farmers.

Why is more support needed for young farmers?

DG AGRI has consistently supported the encouragement of young people to take up agricultural activity and become a driving force behind the sector's future development. The Common Agricultural Policy provides for specific interventions that lower the sector's entry hurdles and supports capacity-building, investments and other measures to promote environmentally and climate-friendly production behaviour. Supporting the next generation of European farmers not only improves the competitive advantages of European agriculture, it also helps secure Europe's food, biomaterials and bio-economy supplies for years to come.

Starting an agricultural business usually requires a substantial investment that reaches full production, and therefore stable cash flow, only after a number of years. Surveys also show that young farmers typically lack collateral and track record to convince banks to finance them and their new farming businesses.

Thanks to the EAFRD support, young farmers can be given a helping hand to get their businesses off the ground, with start-up grants and other, practical support, such as training and advice. Financial instruments, and particularly guarantees, may help in this respect to encourage more banks to support young farmers by lowering the risk profile of the sector, and thereby encouraging more lending to the sector. In combination with interest rate or guarantee fee subsidies, this may also make this financing more affordable to young farmers, encouraging them to enter the sector and start up a new business.

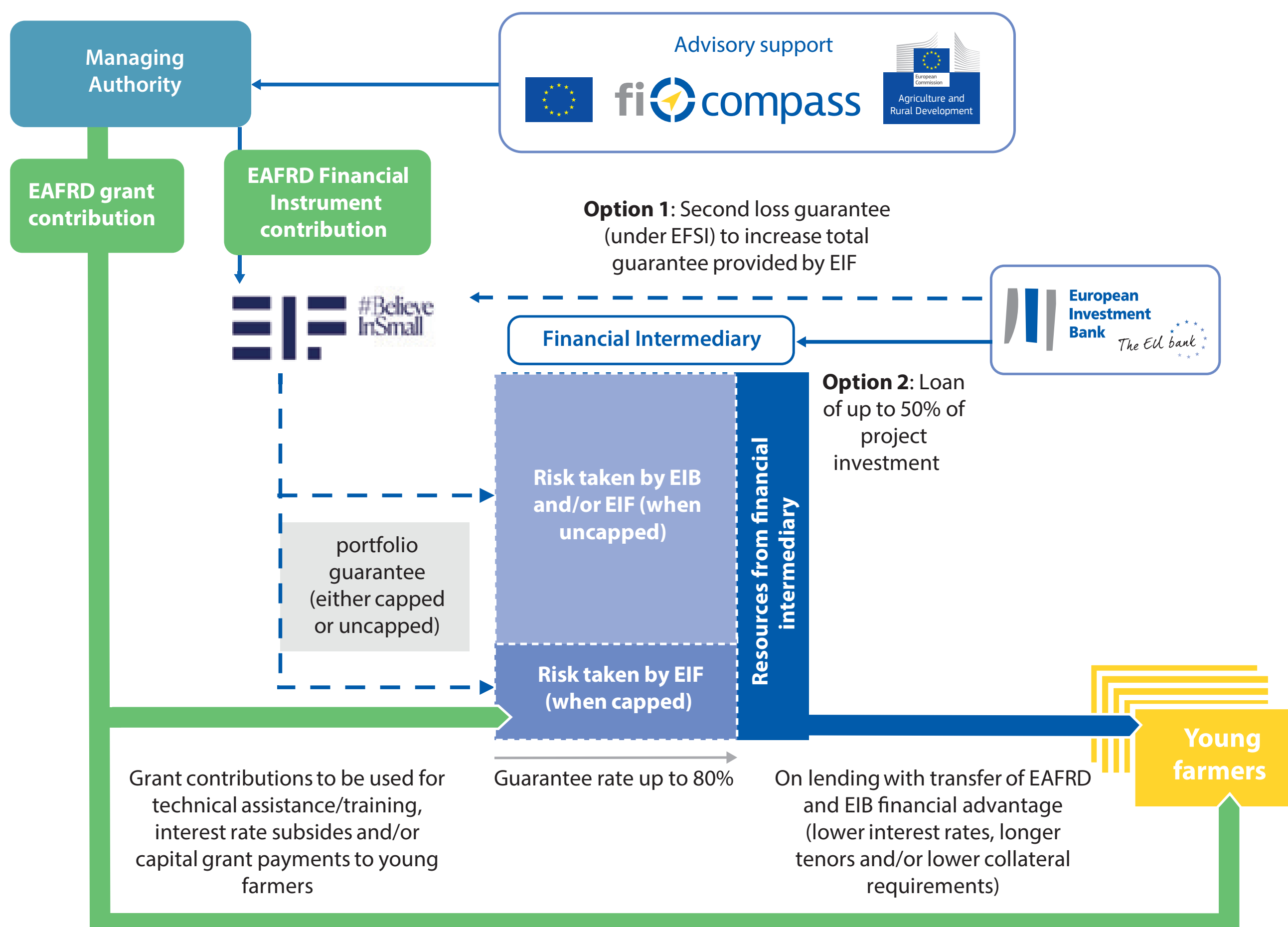
The challenge is great, and cannot be done with public grant funding alone. The use of innovative forms of public support, such as financial instruments, in combination with grants and long-term lending from EIB, national promotional banks and institutions and the commercial banking sector, might therefore further enhance the effectiveness of public policy measures aiming to support generational renewal in agriculture.

What is being offered through this joint young farmers' initiative?

The DG AGRI - EIB Group's young farmers' initiative aims to bring together all forms of EAFRD support and the financial firepower and expertise of the EIB Group. The main building blocks of the Initiative are therefore:

- A new EIB lending envelope for farmers, channelled through specialised intermediary banks, and with a dedicated envelope component for young farmers (as noted in the Foreword);
- Continued use of EAFRD grants for young farmers and start-ups, that may also be used as interest rate subsidies or for technical assistance;
- EIB Advisory support through *fi-compass*, or on a bilateral basis, to EAFRD managing authorities; and
- Managing authorities might also benefit from the European Investment Fund (EIF) fund management expertise of EAFRD-backed financial instruments, to leverage additional funding and expertise from specialised financial intermediaries.

Figure 1: Potential combination options of EAFRD grants and financial instruments with EIB Group lending, fund management and advisory services



What type of support can managing authorities expect?

DG AGRI's ambition, together with the EIB and the *fi-compass* advisory platform (which is delivered in partnership between the European Commission and the EIB) is to raise awareness of these combination possibilities and support an initial number of managing authorities, and banking intermediaries, to pilot these funding and advisory combination possibilities. The experience and lessons learnt from these pilots may then be used to streamline the process further, particularly with respect to combination of grants and financial instruments, and thereby expand its usage as a major EAFRD policy instrument in the post 2020 Multiannual Financial Framework (MFF).

DG AGRI strongly encourages all managing authorities to consider the use of financial instruments, in combination with grants and technical support, as well as EIB Group financing opportunities and advisory support during their preparations for the next MFF. This includes also utilising already available data and survey results such as those available from the *fi-compass* advisory platform.

EIB advisory support in delivering EAFRD financial instruments

EIB Advisory Services (AS), under the European Commission funded *fi-compass* advisory platform, is supporting the European Commission's ambition for greater use of financial instruments under Rural Development Programmes. The ***fi-compass services*** developed for ***EAFRD managing authorities*** aims to provide a better understanding of the available options and to facilitate the setting up of EAFRD financial instruments. A broad range of ***EAFRD specific events*** are delivered by *fi-compass* targeting the representatives from EAFRD managing authorities, farming bodies, financial intermediaries and other relevant stakeholders. A number of studies and surveys have also been developed to facilite the decision-making process of the EAFRD managing authorities;

For those EAFRD managing authorities requiring **tailored advice** in the development and set-up of financial instruments, EIB AS is providing advisory support, including ex-ante assessments, developing investment strategies and fund structures and supporting the selection of financial intermediaries, based on bilateral agreements, and which can be paid for using their EAFRD technical assistance budgets.

1. YOUNG FARMERS' ACCESS TO FINANCE NEEDS

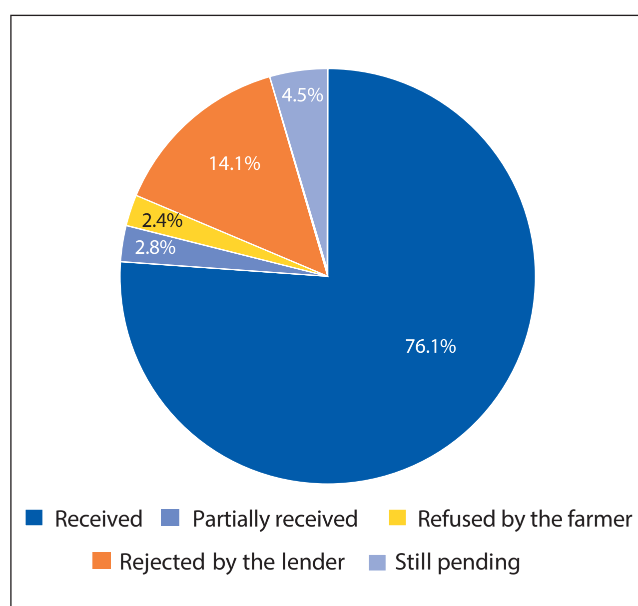
A recent DG AGRI *fi-compass* survey[5], based on interviews of 7,600 farmers in 24 EU Member States[6], found that the financial environment for agricultural enterprises in the EU is characterised by substantial market failures and is relatively under-developed in some Member States.

Agricultural enterprises are less successful in their applications for finance (79% versus 84% of SMEs in other sectors[7]) and are more likely to see their loan applications directly rejected by banks (14% against 5%, Figure 1). Agricultural enterprises are also more likely to see their loan applications directly rejected by banks (more than 14% against 5% for SMEs in other sectors). Farmers also refuse loans twice as often as enterprises in other sectors because the cost is too high.

At the same time, results from another survey conducted by *fi-compass* for DG AGRI in 2018[8] across 57 EU financial intermediaries (banks and guarantee institutions), show that the financial market for agricultural enterprises is expanding, the sector has grown in the last three years (for 84% of the financial intermediaries and for 54% of the guarantee institutions) and is expected to grow further in the next three years (for 74% and 77% of them, respectively).

Young farmers[9] tend to rely more on financial resources provided by private individuals (16.2% against 14.3% for older farmers) and are slightly less confident in approaching the banking system (young farmers were more likely to decide to not apply for finance in the last year due to fear of rejection). Most importantly, they received a very different feedback from banks as compared to their older colleagues. Young farmers were two to three times more likely to have their application rejected by the bank. Agricultural enterprises run by younger managers are around 10% less successful than older farmers in accessing to the full amount requested (see Figure 2).

Figure 2: Percentage of farms applying for finance and result of the application, 2018

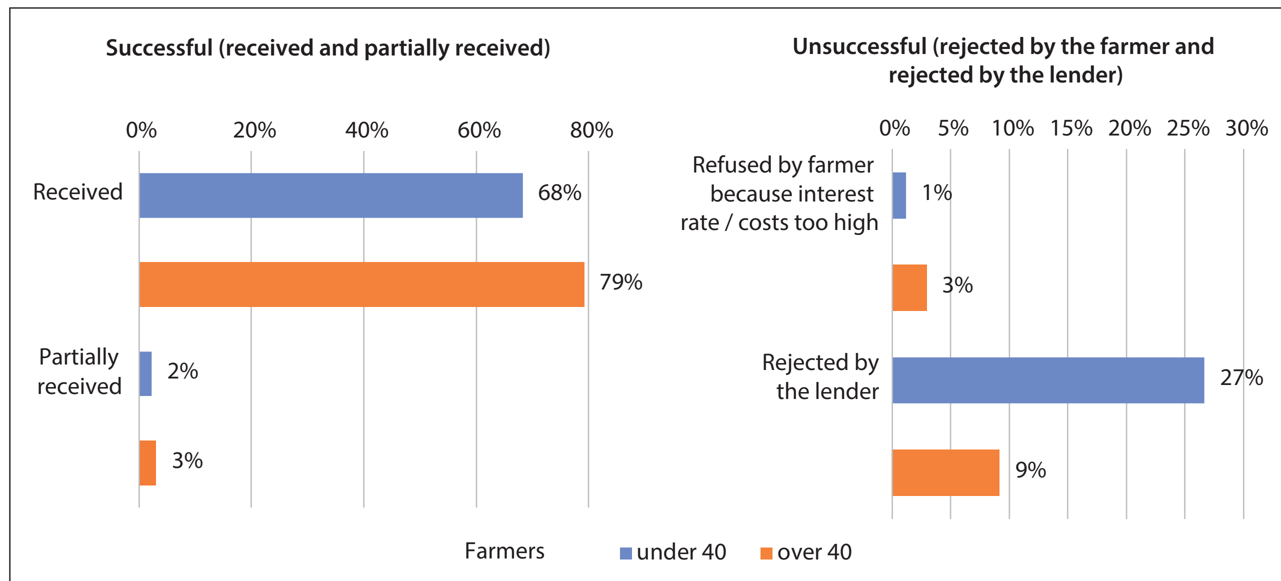


Source: DG AGRI fi-compass survey of EU farmers in 2018.

According to the reasons banks gave in refusing loan applications, 60% of the young farmers do not receive funds because of the perceived risk of their investment (against only 18% for older farmers). In 14% of the cases the rejection is motivated by the concerns and the level of risk associated with a new business activity. Lack of sufficient tangible or intangible assets to be provided as collateral also seems to be a hampering factor hitting negatively more young farmers than the old ones (24% vs. 10%) and inadequate business plans are still a hurdle for 18% of the EU young farmers.

5 *fi-compass* draft report outlining the main results of the survey: "Survey on financial needs of EU agricultural enterprises".
6 All EU 28 Member States with the exclusion of: Cyprus, Luxemburg, Malta and the United Kingdom.
7 Based on the Survey on the access to finance of enterprises (SAFE).
8 *fi-compass* draft report on Debt finance and use of credit guarantee instruments for agricultural enterprises in the EU.
9 *fi-compass* draft report outlining the main results of the survey: "Survey on financial needs of EU agricultural enterprises". Young farmers are defined only on the basis of their age (40 years and below) and available statistics do not necessarily refer to start-up enterprises.

Figure 3: Results of the application of farmers for bank finance

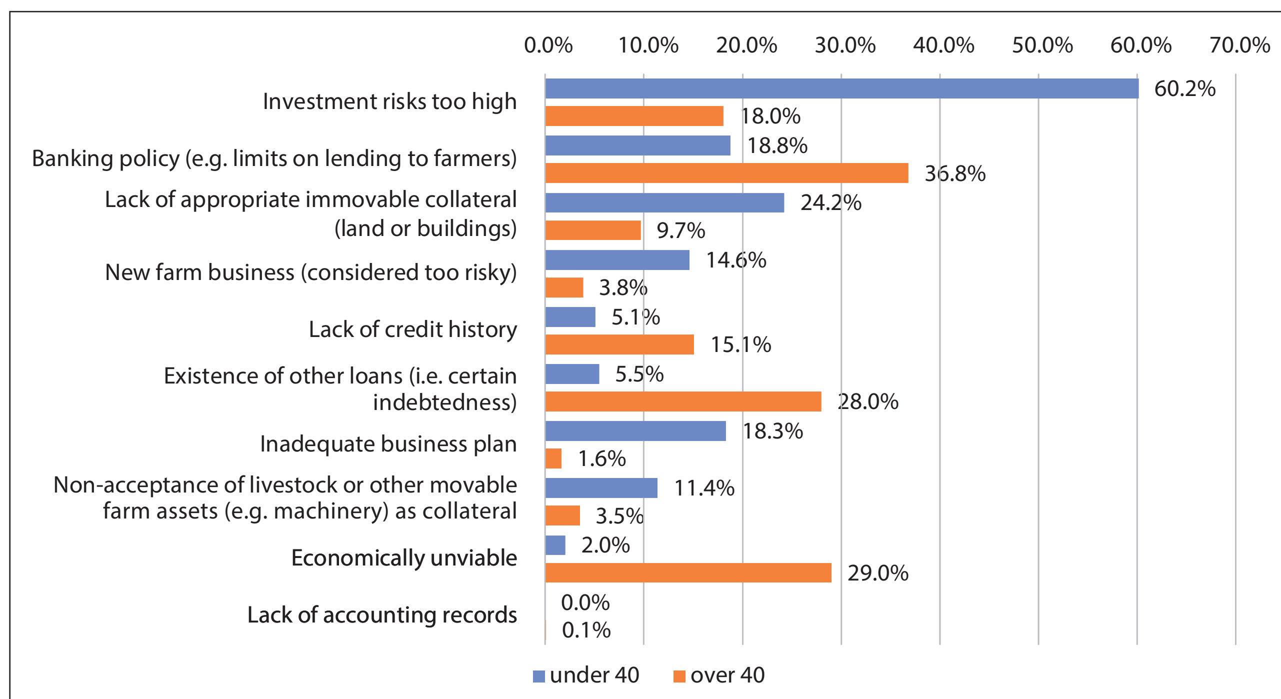


Source: DG AGRI fi-compass survey 2018.

Given young farmers' low farm net asset value in relation to their operation volume, they have relatively less to offer banks in terms of collateral –and this acts as a severe limitation!

Importantly, young farmers' proposals are almost never rejected on the grounds of not being viable. However, rejections appear due to a certain higher risk perception towards the agricultural sector, and towards young farmers in particular. That in itself is a barrier, which creates a group of 'discouraged' farm enterprises, which may need financial resources for their development, but which do not approach banks, due to fear of another rejection, creating a vicious circle.

Figure 4: Key reasons why banks refuse the loan applications of farmers (multiple responses allowed)



Source: DG AGRI fi-compass survey 2018.

DG AGRI *fi-compass* farm survey confirms that young farmers take loans most frequently to invest in mechanisation (63%), followed by working capital loans (43%). Purchase of land seems, on average, to be a less frequent investment (11%) with significant variations between Member States.[10]

The survey on the EU financial intermediaries highlights some specific features related to start-up enterprises. On the one hand banks seem to carefully ponder the turnover/income of the enterprises. They tend to attribute more importance to credit history rather than to the quality of the business plan. In two-thirds of the surveyed cases, EU banks requested higher collateral to agricultural enterprises without a credit history. On the other hand, guarantee institutions' criteria seem to differ, with the highest importance given to the business plan. This may suggest that guarantee providers might be more open to support start-ups, facilitating their access to bank credit.

Guarantee instruments, as a type of a financial instrument supported by the EAFRD, may contribute in enhancing access to credit for young farmers and start-ups.

10 For example, working capital is the main requested purpose for finance in many countries (almost 80% in Greece and Ireland and over 60% in Bulgaria, Denmark, Hungary, Latvia Lithuania and Slovakia). Purchase of land is important for more than 30% of the young farmers in Slovakia, the Netherlands, Estonia, the Czech Republic and Bulgaria.

2. THE BENEFITS FROM USING EAFRD FINANCIAL INSTRUMENTS

At present, Member States offer several possibilities for young farmers' support such as:

- Start-up grant under the EAFRD (Sub-measure 6.1), programmed between EUR 25 000 – 70 000, depending on the programme/country;
- Potential earmarked budget under EAFRD investment support measures (e.g. sub-measure 4.1) or priority for selection under the same measures;
- Higher aid-intensities for agricultural investments support;
- Advisory and training services on various subjects;
- National or regional state-aid schemes that target agriculture, including young farmers;
- Financial instruments for agriculture, of which very few have a specific preferential condition(s) or a scheme for young farmers.

This support is also unequally applied across the EU, leaving large territories where it is not present or is with limited availability. Based on DG AGRI experience, the demand for grants under many existing EAFRD grant calls for farm investments, far exceeds what managing authorities have available. This unmet demand could potentially be compensated with appropriate use of financial instruments that leverage in further private sector financing, including from EIB Group.

The current experience with financial instruments shows that EAFRD managing authorities do not take sufficient advantage of the possibility to combine technical assistance support with financial instruments. There is also insufficient knowledge/awareness of whether advisory services, supported under Measure 2, include training and advice on business plan development and loan applications by (young) farmers.

In Estonia, for example, young farmers pay an interest rate fixed at 2% + ECB rate, which is lower than that charged for other businesses, thanks to a financial instrument with a notional interest rate subsidy component.[7]

In the Midi-Pyrénées Region, the programme allows a higher aid intensity for young farmers (advantage given by the legislation), which is mirrored in the conditions offered under the EAFRD funded, capped guarantee financial instrument[8] in the Region.

In the Romanian portfolio risk-sharing loan, although no better terms are offered to young farmers, financial intermediaries are incentivised, through a management fee mechanism, to provide (more) funding to young farmers from the allocated EAFRD resources.

In Portugal, the managing authority together with the EIF is currently exploring the possibility to set up a financial instrument combining EAFRD with European Fund for Strategic Investments (EFSI) funding, where the support for young farmers' investments in their agricultural holdings is conceived as a separate operation under Sub-measure 4.1.

DG AGRI strongly advocates for the use of EAFRD financial instruments in rural development. Financial instruments may provide tailored support and bring an appropriate mix of public and private resources, which are two key elements that might mitigate some of the constraints young farmers are confronted with.

11 *fi-compass* case study: Loans for rural development 2014-2020, Estonia.

12 *fi-compass* case study: Financial instruments for rural development 2014–2020 Occitanie/Pyrénées-Méditerranée.

There are three main benefits associated with financial instruments:

1. Policy benefits

Financial instruments give the opportunity to EAFRD managing authorities to complement and diversify their support options to agriculture. By enriching their tools and schemes they may address unmet demand in the sector. They can also leverage in private sector expertise in assessing business plans, improving in this way the quality and viability of projects financed also by other types of public support.

2. Investment benefits

EAFRD financial instruments for young farmers can support all types of investments, including machinery, livestock, buildings, annual plants, tangible or intangible assets, transaction costs, and, within certain conditions, they can also support working capital financing linked to investment operations including when supported by a grant.

For the post-2020 MFF, European Commission has proposed that EAFRD financial instruments will also be able to support working capital finance not linked to investment operations, including when supported by a grant. The purchase of agricultural land for young farmers via financial instruments is also proposed to be released from any restriction.

EAFRD financial instruments can be particularly beneficial for farmers lacking credit history and/or sufficient collateral, such as many young farmers and, indeed, most start-ups. They can support businesses bearing higher risk profile levels. A fundamental investment advantage, when compared with grants, is that the young farmer can get the funding upfront, which is also crucial for business start-ups. Any flexibility embedded in the conditions of the loans such as grace periods, longer maturities, and/or lower interest rates, can provide enormous advantages to young farmers.

Financial instruments can also influence the banking sector's behaviour. They may incentivise the financial sector to develop financing schemes that are more adapted to the particular risks associated with agriculture (market volatility, climate risks, etc.). For the banks, financial instruments can also help identify a new client base which, without the EAFRD support, would not have accessible for them to lend to. It gives them a risk cushion with which to develop products to support new entrants and start-up activities in a sector perceived to be risky.

Projects supported through financial instruments, including those for working capital, have to be paid back by the young farmer and this is why banks look at the business proposal and assess the overall (future) viability of the business. Managing authorities could use EAFRD resources to set-up financial instruments, like guarantees, in order to address existing market gaps, reduce collateral requirements of banks, and thereby lower the rejection rates of young farmers' loan applications.

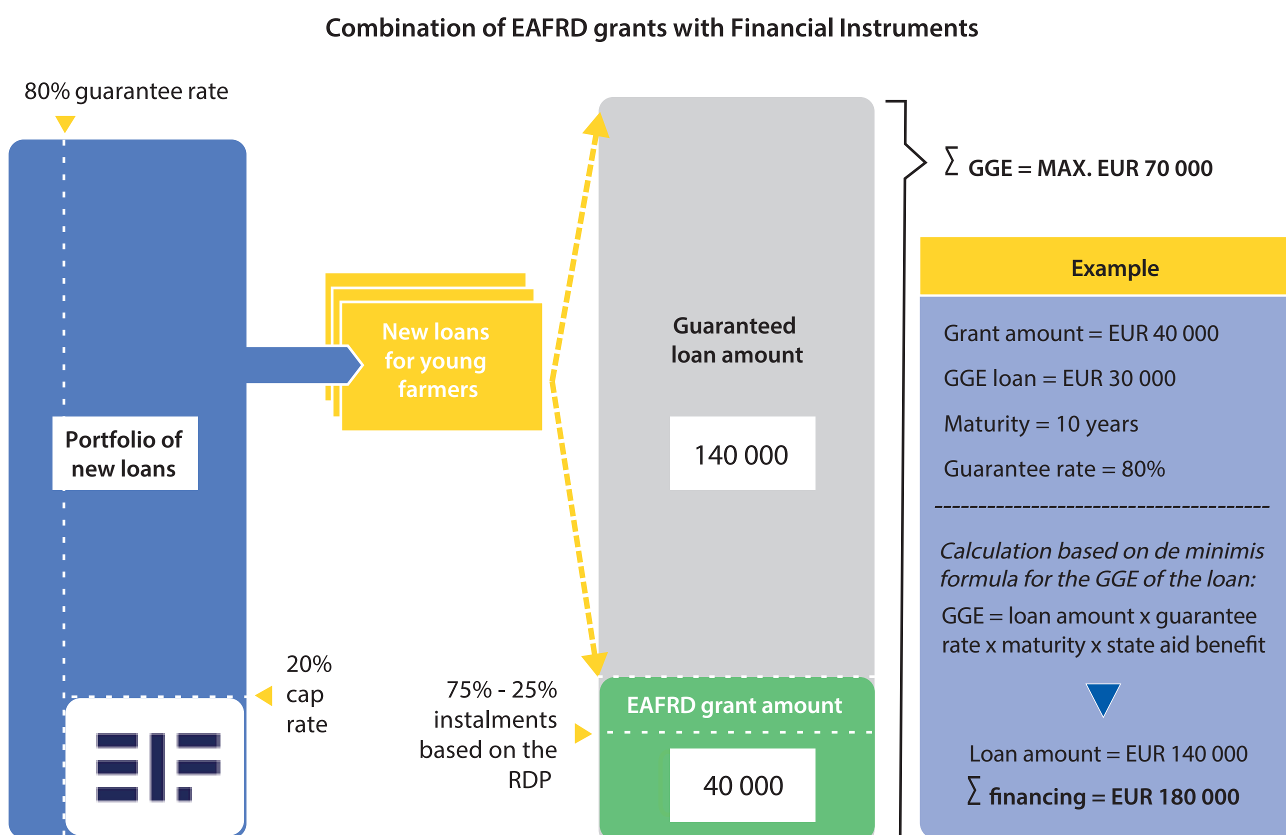
3. Budgetary benefits

Financial instruments can attract additional private resources to increase the volume of financing for young farmers, depending on the type of instrument and its design.

The EAFRD resources paid back by the young farmer to the instrument remain within the Member State or region and can be re-used to cover future financial instruments or farm support options such as top-ups to EAFRD measures, national or regional state aid schemes, etc.

The adoption of the Agri-Omnibus Regulation, in January 2018[13], offers EAFRD managing authorities potential new opportunities to support the setting up of financial instruments dedicated to young farmers. Based on this modification, the support under Measure 6.1 can now be delivered through financial instruments[14]. In this case, the maximum subsidy limit of EUR 70 000, or a part thereof, may be applied in terms of its Gross Grant Equivalent (GGE). Using this grant as a guarantee, for example, could cover bank loans for the provision working capital, independent of the type and scale of the investment, or to purchase agricultural land.

Figure 5: Example of a delivery model for EAFRD financial instrument for young farmers using support under Measure 6.1



Source: EIF presentations.

13 Regulation (EU) No 2017/2393.

14 In order to qualify for the young farmer scheme, the recipient should be no more than 40 years of age, with adequate occupational skills and competence. The measure is open for micro and small enterprises only. The recipient should set up for the first time an agricultural holding as head of that holding and the application for support should be submitted within 2 years after the date of setting up the farm. The omnibus has added that the setting up may be done solely or jointly with other farmers, in any legal form. The recipient should develop a viable business plan that does not exceed 5 years.

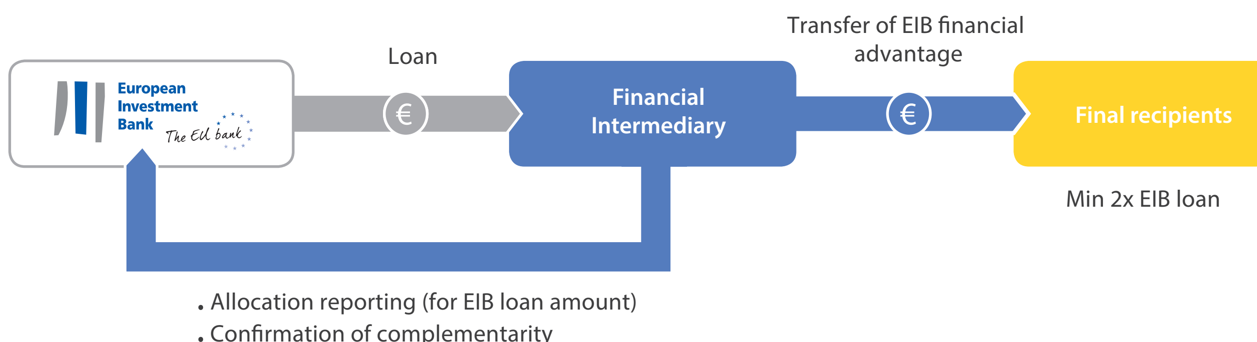
3. EIB GROUP SUPPORT FOR MANAGING AUTHORITIES, FINANCIAL INTERMEDIARIES AND YOUNG FARMERS

The EIB provides support to young farmers through its contribution to the roll out of financial instruments under the EAFRD, and directly through its own lending and guarantee products for projects and final beneficiaries located in the EU Member States. EIB also provides advisory support to managing authorities, both on a bilateral basis and via the *fi-compass* advisory platform.

EIB Group loans

The EIB substantially contributes to the development of the agricultural sector in the EU, including young farmers, through its lending activity. **Multiple Beneficiary Intermediated Loans** (MBIL) are a financial product offered by EIB whereby it provides a loan to a financial intermediary for on-lending to beneficiaries implementing eligible investments. It consists of a source of long-term financing under which the credit risk on the portfolio of loans to final beneficiaries remains with the financial intermediary. The financial intermediary commits to transfer the financial advantage of the EIB resources to the final beneficiaries through lower interest rates and longer maturities. Eligible financial intermediaries include commercial banks or national/regional promotional banks.

Figure 6: EIB (MBILs)



Final recipients are small and medium-sized enterprises (SMEs) and midcaps (i.e. less than 3 000 employees), including young farmers. Also, to enhance EIB intervention, the financial intermediary commits to finance a similar portfolio of SMEs and midcaps for at least twice the amount of the EIB loan.

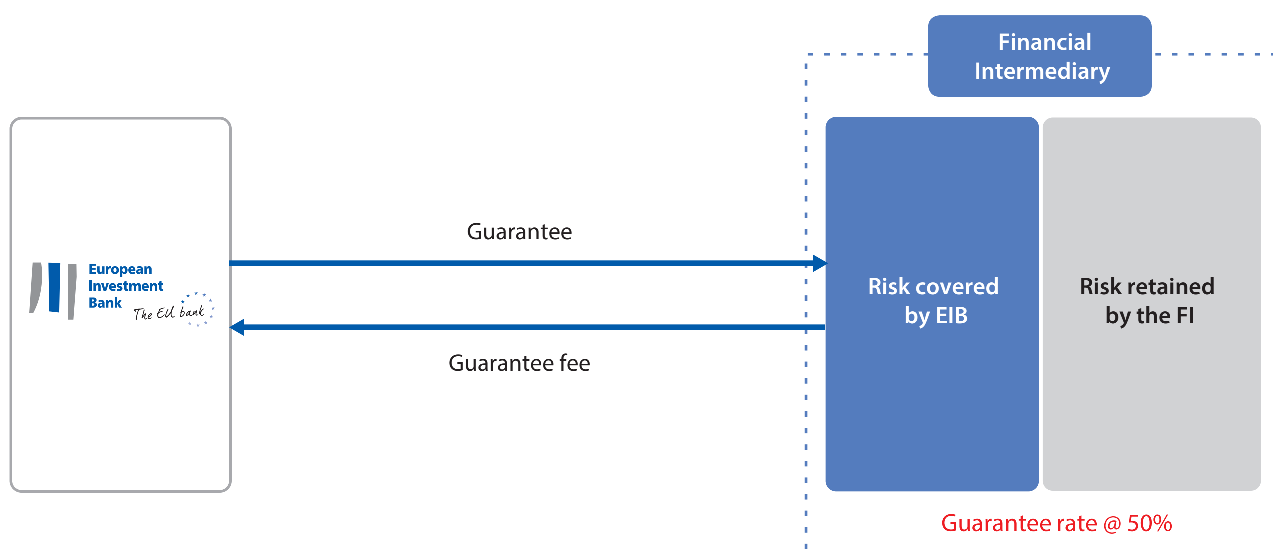
The EIB project appraisal focuses on the creditworthiness of the financial intermediary as well as its origination capabilities and strategy in the targeted segment of final beneficiaries and/or sub-projects. Nevertheless the MBIL is flexible enough to handle changes in the investment programme and the beneficiaries over time. Tenor is up to 10 years depending on credit risk considerations and nature of the underlying assets to be financed.

EIB Group risk sharing instruments and guarantees

Through **risk sharing instruments and guarantees**, EIB Group provides an unconditional and irrevocable first demand guarantee to a financial intermediary covering up to 50% of the losses in respect of each defaulted loan. The loans are allocated by the partner intermediaries according to pre-defined criteria, during an allocation period typically of one to three years.

The guarantee provides capital and/or risk relief to the financial intermediary. Eligible financial intermediaries include national promotional banks, commercial banks and other financial institutions. The product aims at stimulating the origination of new eligible loans, in particular for SME, including young farmers, to improve their access to finance and/or financing conditions.

Figure 7: EIB Group guarantee product



Source: DG AGRI fi-compass survey 2018.

EIB Group advisory support and fund management

The EIB Group can also support EAFRD managing authorities in the design and set-up of financial instruments, or act as a fund manager. A number of financial instruments to support investment in agricultural enterprises are currently being managed by the EIF.

The EIB Group can also contribute to enhance the impact of EAFRD financial instruments providing additional resources (or counter-guarantee) using own resources or EFSI. Annex IV includes an example of how in the current programming period and based on the Initiative of the Commissioner Hogan launched in 2016, the use of EFSI can contribute to increase the impact of a guarantee instrument set up under the EAFRD and for agriculture.

4. ADDITIONAL COMBINATION POSSIBILITIES

Financial instruments such as guarantees and loans can also be combined with other forms of support. The cost for the entire support package can potentially be covered under Measure 6.1, provided that the overall value of the benefits in terms of GGE does not exceed EUR 70 000. The same package can be also proposed under Measure 4.1 (in this case the GGE should respect the aid intensity set for the measure in the RDP).

A support package to complement a financial instrument dedicated to young farmers might ideally include one or more of the following additional options:

1. The provision of **technical support** would help the young farmer to improve its business skills and to obtain the necessary technical advice on the implementation of the business plan or otherwise preparing their project for financing from the financial instrument intermediary;
2. Although financial instruments proposed are already expected to reduce the cost of the financing to farmers, there is still likely to be some form of interest rate charged in order to remunerate the private financial intermediaries participating in the financing. A grant component in the form of **an interest rate subsidy** might also be used to lower the financial cost of the investment even further;
3. In order to provide the young farmer with initial capital, **a cash grant component** might be included in the package, to be used to meet initial costs during the start-up phase of the business.

The first two forms of support above - i.e. technical support and interest rate subsidies - can be combined, as per Article 37(7) of the Common Provisions Regulation (CPR), in a single financial instrument operation. This is possible when other forms of support combined with the financial instrument are directly linked to the financial instrument and are aimed to facilitate and enhance the implementation of the financial instrument. In this case, the managing authority could insure the provision of the entire support package through the selection of (and disbursement to) a financial intermediary.

The possible cash grant component, as well as other technical assistance, in the support package might instead need to be provided though a separate operation on the basis of Article 37(8) CPR[15], which would imply a more complex/co-ordinated procedure involving parties other than the financial intermediary.

The interest rate subsidy and/or cash grant components, might also be used to facilitate the provision of loans with a repayment schedule more specifically targeted to young farmers' needs. This might include, for example, the reduction/elimination of the interest cost during the initial grace period, or offering possible 'principle-repayment holidays' (see examples in the annex). This would allow a young farmer the necessary flexibility to cope with price volatility and, more generally, unexpected changes in market conditions. These types of uncertainties deter both the farmers from seeking the finance, and the financial institutions providing finance to them, thereby also driving up the cost of such finance resulting from these perceived higher risks.

15 More information is available in the Guidance for Member States and Programme Authorities - CPR_37_7_8_9 - Combination of support from a financial instrument with other forms of support: https://www.fi-compass.eu/sites/default/files/publications/GN0144%20-%20Article%2037%20%287-9%29%20CPR%20-%20Combination%20of%20support.pdf

Possibilities to implement financial instruments and cash grants as separate operations but via the same financial intermediaries*

It could be envisaged that the financial intermediary, selected as a manager of an EAFRD financial instrument, might also be the body collecting the cash grant applications on behalf of the young farmer. This intermediary may also receive separate funding from the EIB, including under this initiative, but this would be subject to a separate appraisal and decision making process of the EIB in line with its standard lending policy and procedures.

The receipt of a grant happens after a selection process is carried out, and based on preliminary defined selection criteria (different from the criteria used for assessing the loan application of a farmer). In this context, the facilitation of the work between the managing authority, the paying agency and the financial intermediary, is crucial, for reducing transaction costs, reducing the red tape and facilitating the young farmer's access to all the financial and advisory support available under this initiative.

For reducing transaction costs and facilitating the effort made by the farmer, paying agencies could delegate the admissibility and eligibility checks for the grants, or even the on-the-spot checks, to the selected financial intermediaries, in which way the overall funding of grants and financial instruments is channelled through one body, under the supervision of the paying agency and the managing authority. In that case the intermediary body would collect all documents required for the grant selection and would submit these to the paying agency. It is also possible to form joint evaluation groups where staff from all involved parties (managing authorities, paying agencies, and financial intermediary) work together on the submitted grant applications of the young farmer.

In this context, it is worth mentioning that paying agencies cannot delegate the payments, which have to happen on individual basis between the agency and the farmer, but could be made directly into a bank account the farmer holds with the financial intermediary implementing the financial instrument.

**Note: This box describes 'work-in-progress' exploring the possible ways to implement financial instruments and cash grants as separate operations but via the same financial intermediaries. DG AGRI and EIB are currently looking in further detail how the process could be improved and progress will be respectively updated.*

At present, the Initiative of Commissioner Hogan for combining EAFRD and EFSI resources could also be focused on the delivery of support to young farmers (see Technical annex III), if modified accordingly to address that target specific group and its characteristics on the local markets and in the RDP.

ANNEX I – FINANCIAL INSTRUMENTS FOR YOUNG FARMERS

In this section we present two structures:

A) Start-up support for young farmers – Funded Risk Sharing Loan instrument
B) Start-up support for young farmers – Guarantee instrument

Among all available instruments, these two structures are the only used under the EAFRD.

Option A: Start-up support for young farmers – Funded Risk Sharing Loan

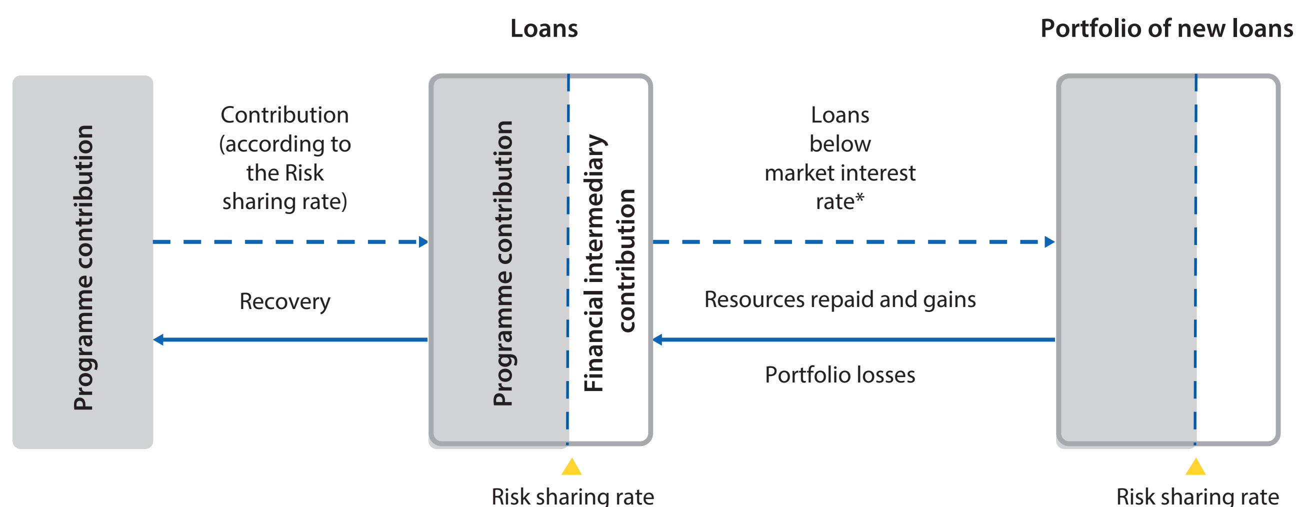
In this structure, following the signature of a funding agreement between the managing authority and the financial intermediary, the managing authority transfers a portion of RDP contributions from the programme (or future CAP Strategic Plans) to the selected financial intermediary which pools together such resources in a dedicated loan fund with a portion of its own funds. The managing authority can directly appoint EIF, EIB or national promotional banks as Fund managers. All bodies with private participation need to go through public procurement process.

The selected body:

- Manages the fund;
- Provides the loans according to the criteria fixed in the funding agreement;
- Contributes to the fund with own additional resources.

Each loan (see Figure 8 below) will be constituted by a public component (based on RDP or CAP strategic plan's resources) and a private one (based on the financial intermediary resources).

Figure 8: Illustration of how a Funded Risk Sharing Loan works



** Full benefit of interest rate is passed to final recipients*

This financial instrument can provide advantages to the borrower based on three mechanisms:

- The public share of each loan is normally provided at a lower than the market interest rate (or even zero rate), with a direct impact on the interest rate of the overall operation;
- Public contribution helps financial intermediaries to operate in cases in which the market is characterised by reduced liquidity;
- The reduced risk for the financial intermediaries is expected to translate into easier access to credit, particularly for specific target final recipients, such as young farmers, lacking assets to be used as collateral or lacking credit history.

Although the managing authority retains the risk of default on the public component of each loan, the financial intermediary is requested to take recovery actions in relation to the entire amount of each defaulted loan in accordance with its internal guidelines and procedures. Amounts recovered (net of recovery and foreclosure costs, if any) shall be allocated pro rata to the risk sharing between the financial intermediary and the managing authority.

In order to make sure that EAFRD contribution is used according to the policy objective set in the RDP or future CAP Strategic Plans, some conditions have to be respected by the financial intermediary:

- Resources should be used to generate a portfolio of new loans (i.e. refinancing of existing loans is not allowed) for operations which are compliant with the eligibility criteria set in the relevant RDP / CAP Strategy Plans' measures.
- Full financial advantage of the RDP / CAP Strategy Plans' contribution must be passed on to the final recipients.

To ensure the latter condition is met, the financial intermediary is required to demonstrate that it uses a pricing policy and a methodology to ensure the transfer of the full financial advantage of the programme public contribution to the eligible final recipients. The pricing policy and the methodology shall include the following elements:

- The interest rate on the financial intermediary share of each loan is set at market basis (according to the financial intermediary's own policy).
- The overall interest rate, to be charged on the loans, must be reduced proportionally to the allocation provided by EAFRD and any other public source. This reduction shall take into account the fees that the managing authority might charge on the programme contribution (if any) and the risk sharing arrangements.

In order to insure a sound management of the instrument, the financial intermediary is also required to respect the following conditions:

- It should originate the agreed portfolio of new eligible loans within a pre-determined limited period of time;
- It should implement a consistent lending policy, especially regarding portfolio diversification, enabling a sound credit portfolio management and risk diversification, while complying with the applicable industry standards and at the same time remaining aligned with the managing authority 's policy objectives;
- The identification, selection, assessment and provision of the loans to final recipients has to be performed by the financial intermediary in accordance with its standard procedures and in accordance with the principles set out in the relevant funding agreement.

Option B: Start-up support for young farmers – Guarantee instrument

In a guarantee instrument, following the signature of a funding agreement between the managing authority and the financial intermediary, the managing authority transfers RDP or CAP Strategic contribution from the programme to the financial intermediary which places such resources in a dedicated fund, which will be used to provide guarantees to eligible loans issued by financial institutions (banks).

Contrary to the loan instrument, the RDP resources are not directly used to provide finance to the final recipients. They are instead set aside in order to reimburse the bank in case of default of the guaranteed loan.

Public guarantee instruments are widely used as a policy tool to alleviate the constraints faced by SMEs, including agricultural enterprises, in accessing finance. By reducing the risk of loss for the bank in case of default, public guarantee instruments are expected to provide additional lending to targeted enterprises (i.e. additional amount of lending that banks would not provide without the guarantee support). This includes additional amount provided by banks to SMEs already included in their portfolios, as well as lending to new clients (e.g. enterprises originally considered to be too risky, also due to asymmetric information problems).

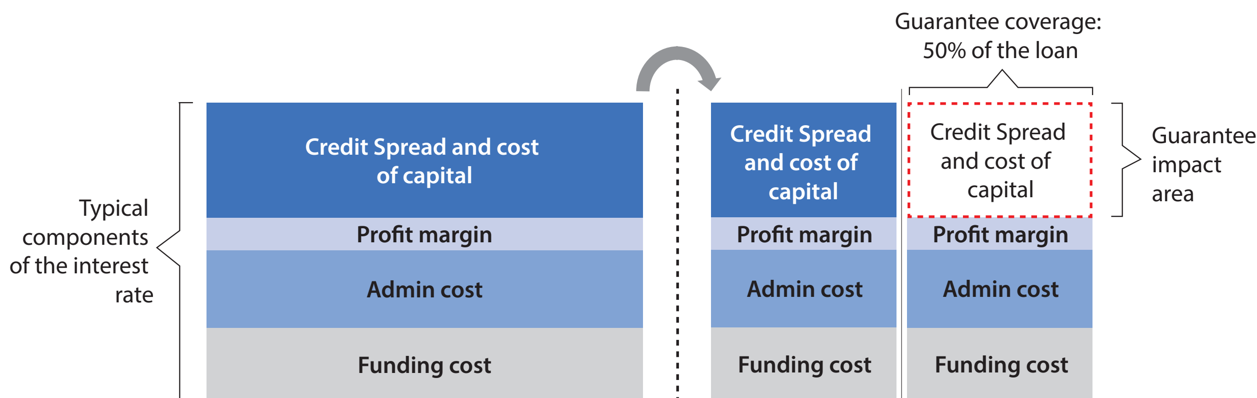
These types of instruments might be particularly beneficial for enterprises with higher risk profile, also due to the lack of credit history and unavailability of assets to be used as collateral, as is often the case for young farmers.

Public guarantees are often provided at a lower-than-the-market guarantee fee, or even at zero fee in some cases. This benefit is expected to be entirely transferred to the supported SME and the bank is normally not charging any additional cost for the guarantee provision.

SMEs who benefit from a credit guarantee can expect additional advantages in terms of more favourable lending conditions, *inter alia*:

- Collateral requirements' reduction: since the bank benefits from the risk coverage of a third party on the loan repayment, the value of collateral requested to the borrower should be significantly reduced. In any case, external guarantees and collateral cannot be considered as perfect substitutes. In fact, they are normally used together in a single loan operation, since the presence of collateral can reduce the risk of moral hazard (i.e. absence of incentives to avoid default) from the borrower.
- Interest rate reduction: since the guarantee reduces the risk of loss for the bank in case of default, the guarantee is expected to have a positive impact on the interest rate. In any case, it is important to consider that the loan interest rate consists of different components, many of which are not affected by the guarantee. The guarantee can only have an impact on the credit spread component (see Figure 9). This component is expected to be reduced as compared to the bank's standard practice applicable to the specific SME.

Figure 9: Impact of the guarantee on the interest rate[12]

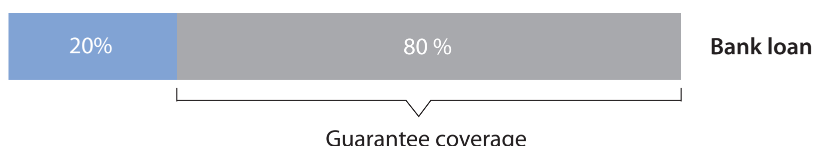


16 The example is based on the assumption that the guarantee is provided free of charge and that provides to the bank full capital relief.

An important aspect of guarantees relates to the arrangements that distribute the losses in case of the borrower's default. Risk sharing arrangements are crucial to adjust incentives to minimise moral hazard from the lenders' side. Risk sharing arrangements can be made at the level of the individual loan, or alternatively, at the level of the portfolio.

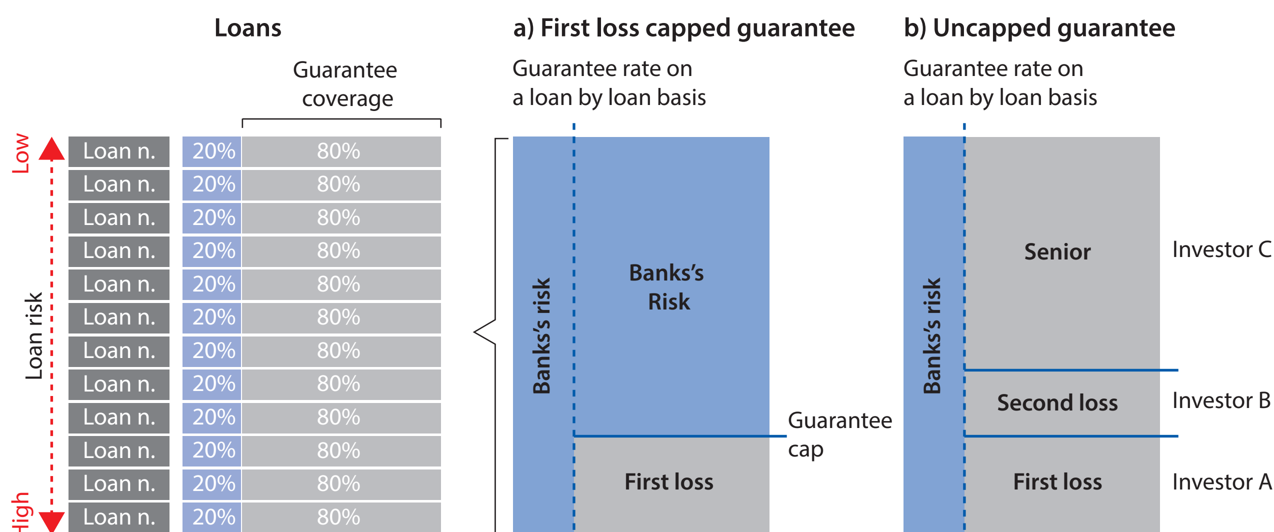
At the individual loan level, guarantees are provided on a pari passu basis: the guarantor covers a fixed share of the loss on a single loan (e.g. 80%). In case the guarantee is called and paid to the bank due to the borrower's default, potential subsequent debt recoveries are shared according to the agreed risk sharing ratio.

Figure 10: Loss-sharing at loan level



Losses on individual loans can be limited (capped) at portfolio level (Capped portfolio guarantee instrument). In this case (Figure 10, a), losses incurred on individual loans will be paid to the bank according to the agreed loss share, but within a ceiling - the Guarantee cap - (corresponding to a given percentage of the total portfolio volume).

Figure 11: Risk Sharing at portfolio level



In an Uncapped portfolio guarantee (Figure 10, b), losses incurred on individual loans are paid according to the agreed loss share with no limits at portfolio level.

In these types of instruments, in order to obtain a more efficient management of the risk at portfolio level, the guaranteed part of the portfolio is divided into tranches with different risks and different levels of seniority. The risk of the different tranches is normally born by different investors (e.g. the first losses due to the first defaulted loans will be covered using the first loss tranche, once the amount correspondent to this tranche is completely exhausted, possible additional losses will be covered using the second loss tranche, etc.).

When default occurs on an individual loan covered under the public guarantee scheme, a guarantee call is triggered by the bank benefitting from the guarantee. The bank calls the payment of the guarantee on the defaulted loan according to the guarantee rate agreed and within the guarantee cap (if applicable) in case of capped portfolio guarantee. Once the guarantor pays the guaranteed amount, the bank is expected to enforce the recovery actions to collect the unpaid loan amount from the borrower. Recovered amounts will be further distributed between the bank and the guarantor to cover the outstanding amount of the default as per the risk sharing arrangements.

In order to make sure that EAFRD contribution is used according to the policy objective set in the RDP or the CAP Strategic Plans, some conditions as in the case with the Funded Risk Sharing Loan have to be respected by the financial intermediary:

- Resources should be used to generate a portfolio of guarantees on new loans (i.e. refinancing of existing loans is not allowed) for operations which are compliant with the eligibility criteria set in the relevant RDP measures.
- Full financial advantage of the RDP contribution must be passed on to the final recipients.

To ensure the latter condition in particular, the financial intermediary cannot charge any additional cost to the guarantee. It should in addition demonstrate that the advantages described above in terms of collateral and interest rate reduction are concretely reflected in the guaranteed loans.

Similar as in the case of risk sharing loan instrument, in order to ensure the sound management of the instrument, the financial intermediary is required to respect the following conditions:

- It should originate the portfolio of guarantees on new eligible loans, within a pre-determined limited period of time;
- It should implement a consistent risk policy, especially regarding portfolio diversification, enabling a sound credit portfolio management and risk diversification, while complying with the applicable industry standards and at the same time remaining aligned with the managing authority's policy objectives;
- The identification and inclusion of the loans in the guarantee portfolio has to be performed by the financial intermediary in accordance with its standard procedures and in accordance with the principles set out in the relevant funding agreement.

Comparison: Use, advantages/disadvantages of the two instruments

The choice between the two instruments depends on the market conditions and the objectives of the managing authority. It should be based, in particular, on the findings of the ex-ante assessment for the use of financial instruments, with reference to the dimension and nature of the financing gap potentially identified.

The guarantee instrument can provide an effective support to tackle risk aversion from the banks, particularly for specific categories of enterprises which lack sufficient collateral, such as young farmers. At the same time, this type of instrument does not provide liquidity to the banks (i.e. banks provide loans with their own funds, whereas RDP / CAP funds are set aside to be used in case of any default happens).

If banks struggle to find the provision of funding to provide loans to enterprises (e.g. in case of a financial crisis), a loan instrument might be the most appropriate tool.

The risk-sharing loan instrument illustrated at Option A provides, in addition to liquidity, also risk protection, since the risk for the RDP/CAP resources is retained by the managing authority. In this sense, it can offer also the advantages provided by a guarantee fund. This instrument offers as well a higher reduction on the interest rate as compared to the guarantee (i.e. allows the managing authority to provide loans with at a more favourable interest rate).

The disadvantage of the loan fund structure is that it absorbs a higher amount of public resources, as compared to the guarantee structure. Guarantee instruments offer higher leverage (i.e. amount of resources that reach the final recipients for each euro of RDP committed resources).

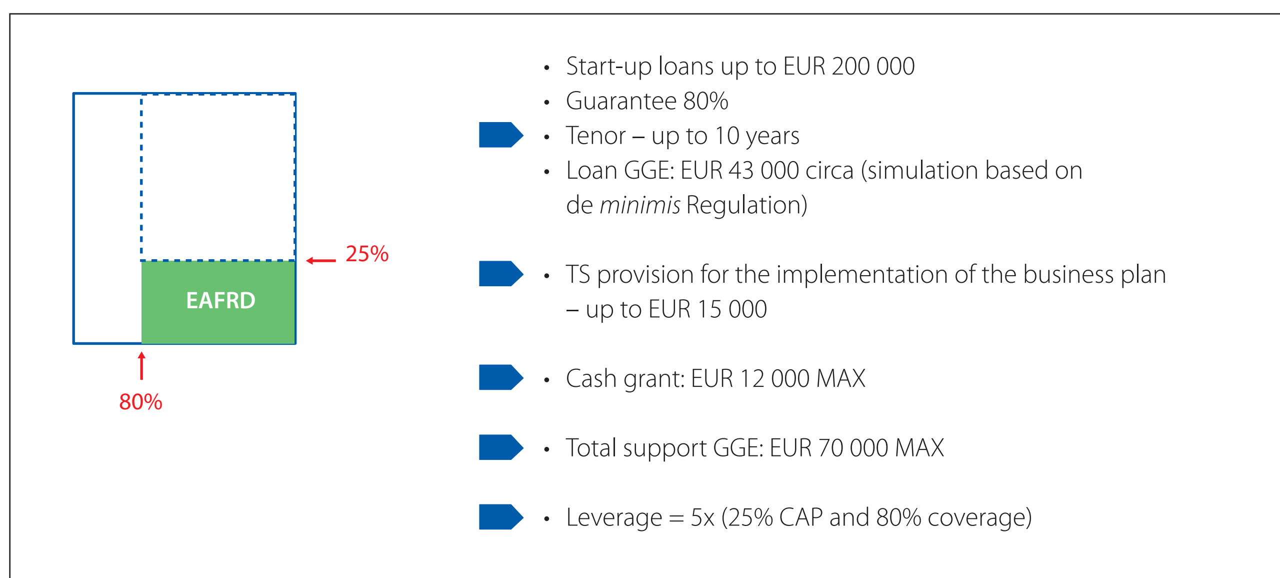
The table below summarises the main advantages and disadvantages of the two options.

Comparing the guarantee and the funded loan instruments		
Options	**PRO**	**CON**
Funded risk-sharing Loan	• Provides at the same time liquidity and risk protection to the banks • Higher impact on the interest rate • Can provide reduction of collateral requirements	• Lower leverage (i.e. higher RDP resources absorption)
Guarantee instruments	• Support access to credit of enterprises with low level of collateral (e.g. young farmers) • Provides reduction of collateral requirements • Higher leverage (i.e. high impact with low RDP resources absorption)	• Does not provide liquidity to banks (i.e. they have to use entirely private funds to provide loans) • Impact on the cost of financing (i.e. interest rate) is limited • Slower reflow of the resources

ANNEX II – EXAMPLES OF COMBINING FINANCIAL INSTRUMENTS WITH TECHNICAL ASSISTANCE/TECHNICAL SUPPORT AND OTHER GRANT FUNDED COMPONENTS

In this section, some examples of support package are presented. They are based on the use of Measure 6.1, with a GGE limited to EUR 70,000. As mentioned before in the document, similar support packages may be envisaged also under Measure 4.1. Finally, the support of the two measures might also be combined to provide a higher level of support for start-up projects.

Example 1 – Guarantee instrument including technical support and cash grant



The instrument provides the following benefits to the young farmer:

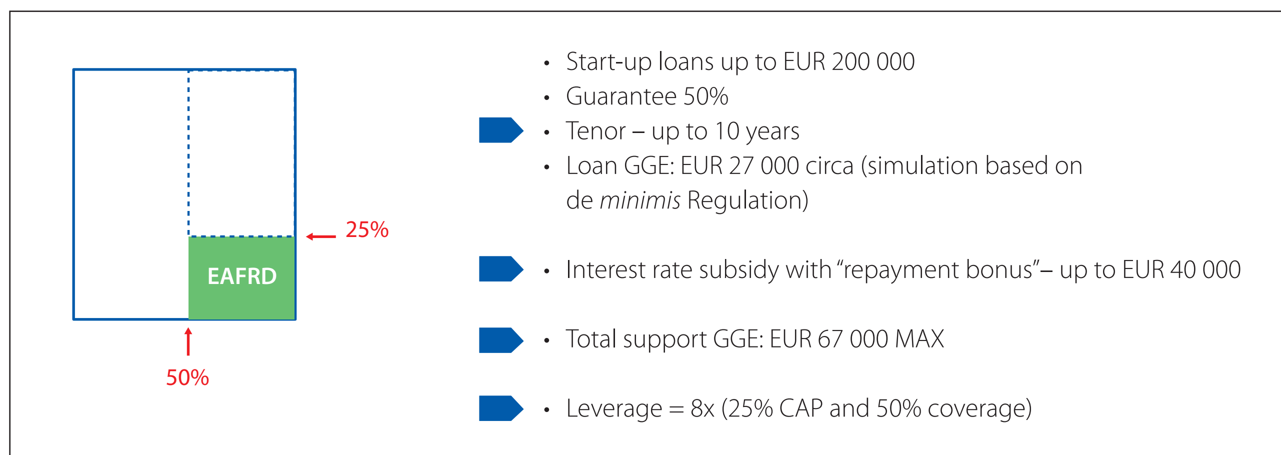
- Guarantee free of charge to cover 80% of a start-up loan of EUR 200 000 with 10 years maturity;
- Technical Support package for the development of the business plan for a value of EUR 15 000;
- A cash grant amount of EUR 12 000.

The total value of the support received by the young farmer is the following:

Guarantee free of charge on the loan (GGE)	EUR	43 000[17]
Technical support package	EUR	15 000
Cash grant	EUR	12 000
TOTAL	EUR	70 000

17 GGE estimate based on the methodology outlined in Regulation (EU) No 1407/2013. The guarantee is considered to be provided free of charge. In case a guarantee fee is applied the support for the guarantee in terms of GGE would be smaller.

Example 2 – Guarantee instrument including repayment bonus option



The instrument provides the young farmer with a guarantee on start-up loans which includes a 'repayment bonus'[18]. This is an option for the farmer to request the suspension of the reimbursement of the loan principle for a maximum of 12 months. The option can be activated twice during the maturity of the loan. The unpaid principle shall be reimbursed through an extension of the loan maturity.

The instrument provides the following benefits to the young farmer:

- Guarantee free of charge to cover 50% of a start-up loan with 'repayment bonus' of EUR 200,000 with 10 years maturity.
- An interest rate subsidy correspondent to EUR 40 000 provided with the following structure:
    - Full coverage of the interest cost during the initial grace period (interest-only instalments) for a period of 24 months;
    - Full coverage of the interest cost during the suspension period(s);
- The balance of the interest subsidy at the end of the loan maturity.

The total value of the support received by the young farmer might be the following[19]:

Guarantee free of charge on the loan (GGE)	EUR	27 000[20]
Interest rate subsidy[21]:		
Y1 – grace period	EUR	7 600
Y2 – grace period	EUR	7 600
Y4 – principle repayment suspension	EUR	6 600
Y7 – principle repayment suspension	EUR	4 300
Y12[22] – balance of the interest subsidy	EUR	13 900
TOTAL	EUR	67 000

18 The suspension of the principle and the prolongation of the loan maturity repayment should be accepted by the intermediaries benefitting from the guarantee.

19 Subject to the assumption that the young farmer benefits from the principal repayment suspension in Y4 and Y7.

20 GGE estimate based on the methodology outlined in Regulation (EU) No 1407/2013. The guarantee is considered to be provided free of charge. In case a guarantee fee is applied the support for the guarantee in terms of GGE would be smaller.

21 The interest subsidy is calculated on the basis of an amortisation plan based on constant capital repayments in quarterly instalments. The interest rate used in the calculation is the one for start-up enterprises indicated in the Communication from the Commission on the revision of the method for setting the reference and discount rates (2008/C 14/02). Figures in the simulation are rounded and reported at nominal value (the total present value of the interest subsidy is below EUR 40 000).

22 The final maturity of the loan is 12 years considering the extension due to the suspension of the principle repayment for 24 months during the maturity.

An example of a loan instrument including a 'repayment bonus' is presented below. It goes without saying that the possibility to concretely implement such a mechanism is subject to the agreement of the financial intermediaries participating in the operation with their own financing. A recent *fi-compass* study dedicated to flexible financial instruments for farmers in the EU[23], however, shows that similar structures are already available in the market, although, at present, only by a limited number of intermediaries, concentrated in a few EU Member States.

Young farmers could benefit from a predefined amount, within the maximum aid amount foreseen under Measure 6.1, to cover interest costs. These farmers could benefit from the following options:

- The loan contract to young farmers may include a capital grace period of up to 24 months, were only interest payments are due: an interest rate subsidy could, for example, be used to effectively reduce the interest payments needed during the grace period.
- The loan contract may include an option for the farmer to temporarily suspend the repayment of the principal and of the interest for a limited period of time. For example the loan contract could foresee the possibility to suspend the repayment of the loan principal and the interest for 12 months. The option can be activated twice during the maturity of the loan.
- The unpaid principal during the suspension period would have to be paid back either through a prolongation of the maturity of the loan or through an increase of the remaining instalments (the financial instrument should embed a mechanism to facilitate this flexibility (e.g. extension of the duration of the guarantee contract in case of extension of the loan maturity). In addition, the farmer may benefit from a grant payment, in the form of interest subsidy, which could cover the interests accumulated during the suspension period.
- If, after applying for the two options above, the maximum aid amount (i.e. EUR 70,000) foreseen under Measure 6.1 is not reached, the farmer could benefit from a cash bonus, to be provided at end of the reimbursement period, equivalent to the difference between the maximum aid amount and the aggregate amounts of subsidy received until that moment. Such mechanism could contribute to increase young farmers to benefit from some flexibility during difficult periods (e.g. low prices) and, at the same time, set an incentive for a stronger financial discipline of the borrower.

With these incentives financial intermediaries could be able to offer a flexible product to the borrower with no additional costs. The flexibility in the repayment schedule could reduce the risk of default. This should potentially result in better conditions for young farmers in terms of access to finance, cost and collateral requirements.

23 Flexible financial products for the agricultural sector in the EU, *fi-compass*, final draft report, July 2018.

Example 3 – Loan instrument including technical support

EAFRD	Financial Intrument	
65%		• Start-up loans up to EUR 200 000 • Public component of the loan 65% • Tenor – up to 10 years • GGE: approx. EUR 52 000 (simulation based on de *minimis* Regulation)
		• TS provision for the implementation of the business plan – up to EUR 15 000
		• Total support GGE: EUR 67 000 MAX
		• Leverage = 1 54x

The risk sharing loan instrument provides loans at preferential rate to young farmers. In particular, every loan includes a public component (65%) provided at zero interest rate and a private component (from a private financial intermediary) provided at market rate.

The instrument would provide to the young farmer the following benefits:

- Start-up loan of EUR 200,000 with 10 years maturity, at preferential interest rate;
- Technical Support package for the development of the business plan for a value of EUR 15 000.

The total value of the support received by the young farmer is the following:

Reduction of the interest rate (GGE)	EUR	52 000[24]
Technical support package	EUR	15 000
TOTAL	EUR	67 000

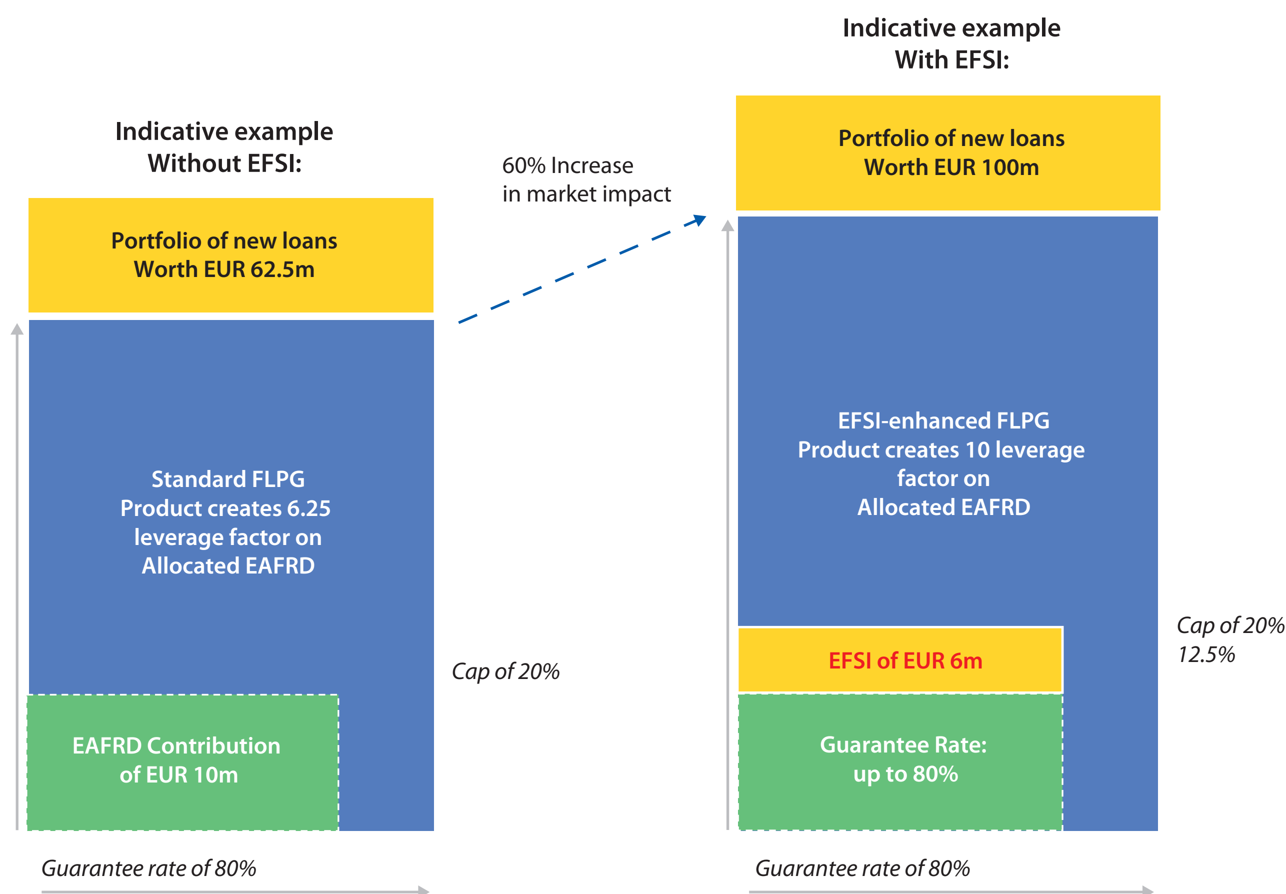
24 GGE estimate based on the methodology outlined in Regulation (EU) No 1407/2013. The public component of the loan is considered to be provided at zero interest rate. In case an interest rate is applied on this component of the loan the support received in terms of GGE would be smaller.

ANNEX III – GUARANTEE INSTRUMENTS COMBINING EAFRD WITH EFSI

The EFSI can be used to improve the effectiveness of financial instruments by combining its support with ESI Funds in the form of investment platforms. For the EAFRD and, for example, portfolio guarantee instruments, this combination is possible based on the general Omnibus Regulation amending the CPR[25].

With the top up from EFSI complementing the EAFRD resources in the financial instrument, a higher leverage effect and subsequent market impact could potentially be achieved as opposed to financial instruments using EAFRD resources only. The volume of the portfolio of new loans can be increased significantly, which would contribute to enhanced capacity to achieve the policy objectives of the respective RDP and CAP. The Figure 12 below shows the potential impact of the combination of EFSI resources in an uncapped guarantee instrument. The impact is similar in case of an uncapped structure.

Figure 12: Potential impact of the combination of EFSI resources in an uncapped guarantee instrument



25 Regulation 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012.

EFSI can contribute to a financial instrument, provided that it delivers, inter alia, the achievement of the objectives of the EAFRD and to the Union strategy for smart, sustainable and inclusive growth[26] and the EAFRD contribution does not exceed 25% of the total support provided to the final recipients[27]. In general, EAFRD contributions are provided free of charge to cover the first loss, while EFSI contribution, might involve a price premium depending on the type of instrument and subject to the decision of the EC in this regard.

The EAFRD-EFSI combination is possible in both capped and uncapped portfolio guarantees (in the latter case, other investors may have to contribute to the senior tranche of the guarantee). A 'boosted' capped guarantee would allow coverage of both expected and part of the unexpected losses of the portfolio.

26 The use of EFSI within the present scheme is in any case subject to approval by the relevant EFSI governance bodies. In this respect, the operation should be in line with both EFSI and EIB eligibility criteria (e.g. EFSI backed contribution from EIB to the financial instrument cannot be used to finance purchase of land).

27 In the less developed regions referred to in point (b) of the first subparagraph of Art. 120(3) of CPR, the financial contribution may exceed 25 % where duly justified by the assessments referred to in Art. 37(2) or in paragraph 3 of this article, but shall not exceed 40%.

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