

Case study name	Fraud in risk capital funds
<b>Description</b>	<p>A risk capital fund was set up in a region of one MS with ERDF support. The fund was to provide risk capital to technology-oriented innovative SMEs located in the specific region in their early stages. Market-oriented innovation or support of research and development were mandatory criteria for the EU support within the Fund, which also excluded companies in difficulties.</p> <p>The risk capital fund was implemented by a beneficiary who had to identify investment opportunities within the terms and conditions of the investment strategy on the basis of which it was selected. In order to comply with state aid rules, the regional authorities had to select the management of the fund through an open and non-discriminatory tender procedure with the aim of securing efficient, commercial management for the fund, while reflecting market practices.</p> <p>The stakeholders who were investigated included the manager of the risk capital fund, his friends and business partners, and one other investment manager. The investigation did not only concern one single project but the participations of a risk capital fund in the whole region of the MS.</p>
<b>ESI Fund(s) concerned</b>	European Regional Development Fund (ERDF)
<b>Irregularity type</b>	<p>Type of irregularity detected.</p> <ul style="list-style-type: none"> <li>○ Breach of funding rules</li> <li>○ Conflict of interest</li> <li>○ Failings in tender procedures</li> <li>○ Insufficient supervision by the competent authorities</li> </ul>
<b>Reporting mechanism</b>	<p>Following its investigation, OLAF issued a financial recommendation to the EC/DG REGIO to recover €162.3 million and addressed a judicial recommendation to the national judicial authorities in relation to the fraudulent activities. The case was ultimately dismissed. The recovery procedure for the ERDF funds already paid out (€162.3 million) is still on-going.</p>
<b>IMS reporting</b>	No
<b>Red flag(s)</b>	<p>The fraud indicators and signals that triggered the suspicion were:</p> <ul style="list-style-type: none"> <li>• The favored participants of the risk capital fund were companies owned by one family.</li> <li>• Private investments of the fund manager into the portfolio companies of the fund.</li> </ul>
<b>Description of fraud pattern</b>	<p>The irregularities mainly concerned the breach of the selection criteria for the participations of the risk capital fund. The risk capital fund, which was run by the same management before and after it</p>

	<p>was privatized, made irregular investments in 44 companies, disregarding the investment criteria. For example, companies which were not small or medium-sized (SME) received funding, as well as enterprises in financial difficulties or companies threatened with insolvency. This contravened the eligibility criteria set for EU funding.</p>
<p><b>How the fraud was detected</b></p>	<p>The suspicions of fraud and irregularities were reported by a whistleblower and by the press. The allegations brought forward suggested that the investment team of the risk capital fund had favored companies which were not eligible for an investment under the European Structural Funds rules in the funding period 2000-2006 and 2007-2013.</p> <p>OLAF examined a third of the total fund portfolio of the investment team of the risk capital fund and concluded that the risk capital fund made irregular investments and disregarded investment criteria. However, the suspicion of fraud could not be confirmed as the case has been dismissed by the judicial authorities</p> <p>OLAF carried out its activities independently and cooperated with different national authorities. OLAF's investigation uncovered irregularities and suspected fraud as well as significant deficiencies in the control obligations of the national authorities, and confirmed serious flaws in the privatization process of the risk capital fund.</p>
<p><b>Difficulties encountered</b></p>	<p>The case involved a large number of portfolio companies. OLAF could only carry out a limited number of on-the-spot-checks. Information related to the portfolio companies was only available via the information collected at the risk capital fund. Some of the companies involved had already been dissolved. The authorities were reluctant to provide OLAF relevant information.</p>
<p><b>Weakness identified</b></p>	<p>Deficiencies in the management and control system were confirmed by OLAF and by the Regional Court of Auditors of the Member State.</p> <p>The eligibility criteria set for EU funding which should prevent this type of irregularity and fraud are now in place. Furthermore since the 2018 revised Financial Regulation, the definition on conflict of interest is extended to shared management funds and EC guidance on conflict of interests is available to MS.</p>