FI-Lab B
Brainteaser session – State aid and financial instruments

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State aid and financial instruments

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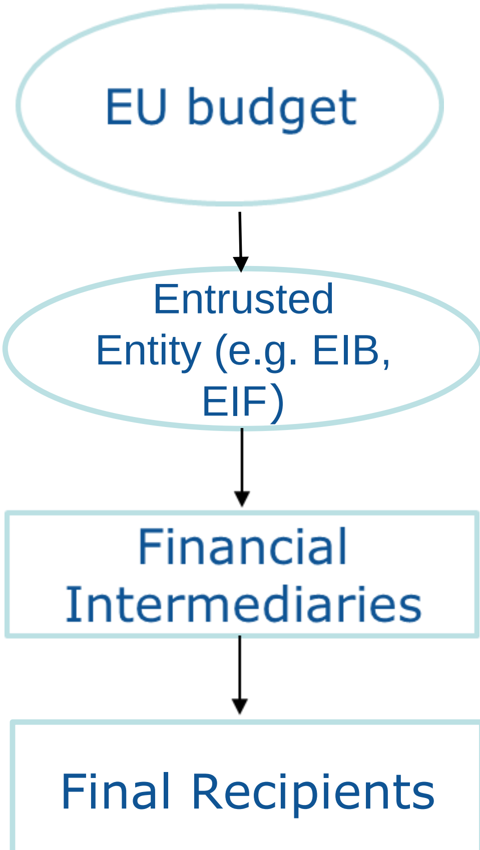
Centrally managed EU FIs



- **Characteristics:**
  - Designed at an EU level and financed from the central EU budget
  - Managed directly by the Commission, or indirectly, based on an entrustment to EIB/EIF
  - Entrusted entity is usually the EIB/EIF, that invests directly or indirectly via financial intermediaries
  - No geographic allocation: final beneficiaries compete on same eligibility criteria
  - No discretion to the States
- **State aid aspect:**
  - Not State aid, but according to Article 140(2)(c) Financial Regulation, EU Financial Instruments shall be consistent (not compliant) with State aid law
  - State aid consistency is ensured by the European Commission
- **Examples for 2014-2020:**
  - Horizon 2020 (InnovFin) for innovative SMEs and midcaps

European Commission

European Investment Bank The EU bank

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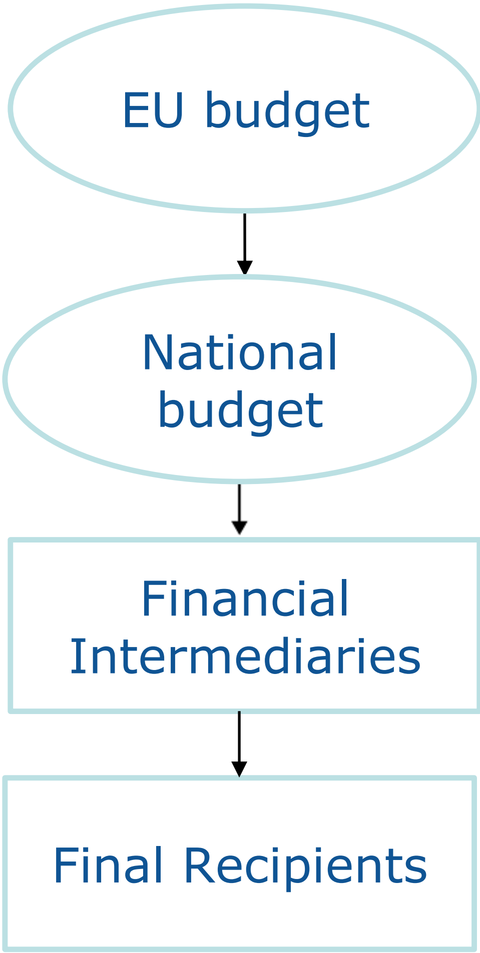
FIs in shared management



- **Characteristics:**
  - ➢ Financial instruments financed from the EU budget, but flowing through the national budget
  - ➢ Managed by MS
  - ➢ MS may entrust the management to EIF/EIB
  - ➢ MS retains some discretion in the design of the measure
- State aid aspect: ESIF/ESF shall be compliant with State aid law

How to approach Financial Instruments from a State aid point of view

State aid may be present at several levels, for all economic operators involved:

➔ compliance with state aid rules at final recipient level is not enough

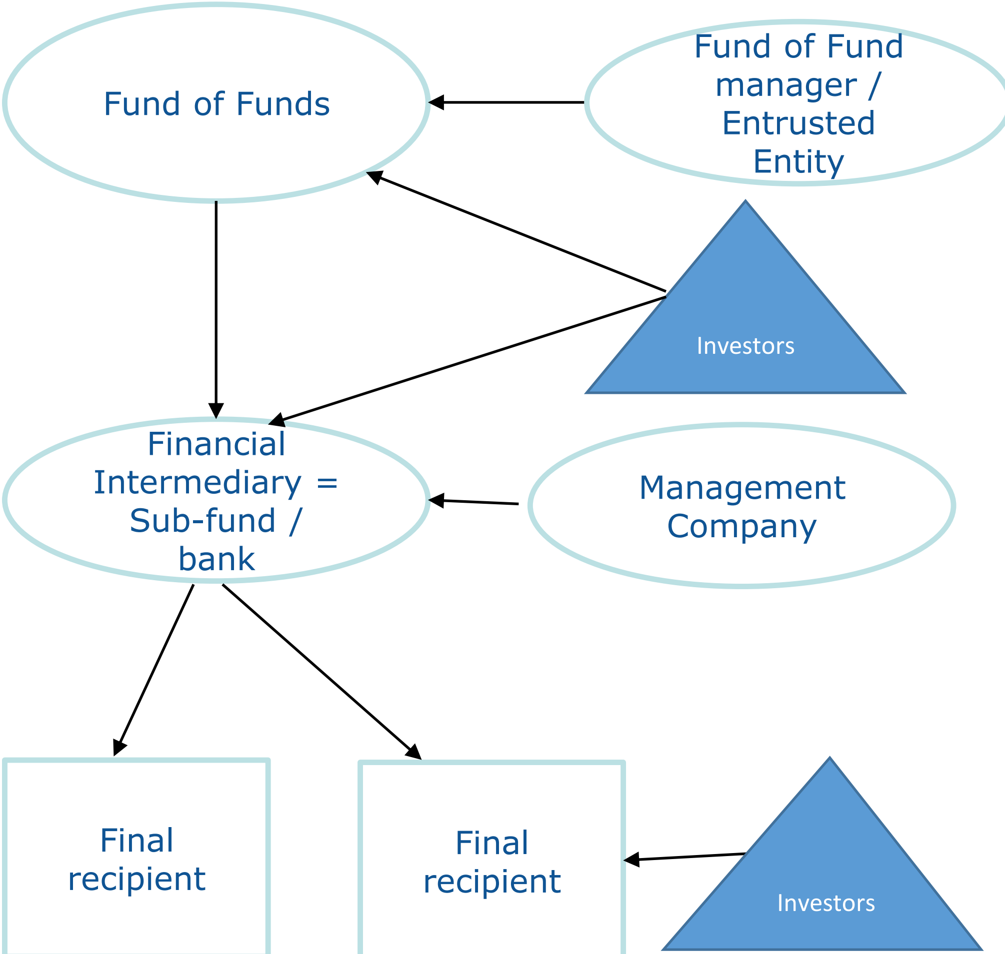
- Private investors
- Financial intermediary = bank / investment fund / guarantee society, etc.
- Fund managers
- Final recipients = undertakings

State aid legal base determines the entire design of Financial Instrument:

➔ need to choose the state aid legal base first

- Eligibility criteria
- Maximum amount per final recipient
- Minimum private investment
- Financial parameters
- Governance parameters

Economic Operators



- Fund of funds is typically (semi) public
- Financial intermediaries are typically banks, funds
- Sub-funds may have specific eligibility focus
- Sub-fund may have or not a legal personality
- In case fund is only a mass of assets, it is managed by a management company independent from the fund. Necessary to verify whether manager benefits of aid.
- Investors may invest at any level

State aid legal base options

De minimis aid (legal presumption of no State aid)

GBER

(Compatible Aid)

Market Conform (no State aid)

Notified Aid

(Compatible if approved)

Private Investors I

- Investors will not benefit of aid if investment between public and private investors is ***pari passu***:
  - Same terms and same conditions = like risk like reward in same risk class, and
  - Simultaneous investment, and
  - Independent private investment is significant: min. 30%
  - Risk Finance Guidelines, paras. 31-34
  - Notice on Notion of Aid, paras. 86-88

- Private investor will not benefit of aid if based on **bench-marking / other assessment methods**, the return is similar or lower than market returns, Notice on Notion of Aid, section 4.2.3.2

- Private investor will not benefit of aid if all advantage is passed on to final recipients, e.g. SME Initiative

Private Investors II

- Private investor will receive aid if it retains advantage:

  - receives **better return/conditions** than on the market:
    - Priority return in time
    - Better than pro rata share of profit

  - suffers lower losses than on the market:
    - First loss piece taken by public
    - Priority return in case of insolvency
    - Seniority compared to public investor

Market-conform public investments

- A public investment that fulfils the criteria of the market economy operator test, does not constitute aid
- No need for notification and prior approval before implementation

A. ***Pari passu*** investment between public and private investors:
- Same terms and conditions = like risk - like reward, and same level of subordination in the same risk class, and
- Simultaneous investments, and
- Economically significant private investment (min 30%)

B. Benchmarking / Market returns (IRR)

C. Legal presumptions

Market conform loans & guarantees

Objectives:

A. Legal presumption of no aid: Determines the conditions of market-conform investments

B. Guidance to quantify the aid element

Loans – Reference Rate Communication: sum of base rate and risk premium

1. Base rate: 1-year IBOR of the corresponding currency
2. Risk premium: loan margin, depending on the rating of the firm applying for the loan and the collaterals offered

Guarantees – Guarantee Notice:

1. The Borrower is not in a financial difficulty
2. The guarantee is linked to a specific transaction
3. The guarantee doesn't cover more than 80% of the outstanding loan
4. A market-oriented price is paid for the guarantee

de minimis aid

- **Presumption = no State aid** because *de minimis* aid is deemed too small to affect trade or distort competition and thus not fulfilling all the criteria of Article 107(1) TFEU

- Maximum **EUR 200 000** over any period of three fiscal years
  - if the ceiling is exceeded the whole amount cannot benefit from the Regulation, not even the fraction below the ceiling
  - per single undertaking

- **Form of *de minimis* aid**:
  - Grant/interest rate subsidy ➔ € 200 000 GGE
  - Equity/quasi-equity ➔ € 200 000 GGE
  - Loan ➔ 2 methods to calculate the GGE
  - Guarantee ➔ 3 methods to calculate the GGE

GBER Art. 21 – Risk finance aid

- **Indirect access to finance measures implemented through financial intermediaries**
- **Amount:** EUR 15 million total cap/SME
- **Eligible SMEs:**
  - A. SMEs before 1st commercial sale
  - B. SMEs within 7 years from first commercial sale
  - C. SMEs requiring higher initial investment than 50% of average annual turnover, with a view to entering into new product or geographic market
- **Minimum private investment to reflect riskiness & development stage:**
  - 10% - before first commercial sale
  - 40% - until 7 years post first commercial sale
  - 60% - follow-on investment beyond 7 years post first commercial sale
  - weighted average for multi-stage financial intermediaries
- **Forms of Financial Instruments:**
  - Equity/quasi-equity
  - Loan
  - Guarantee
- **Financial intermediaries have to pass on the benefit to the final recipients to the maximum extent possible**

5 Off-the-Shelf FIs

- Standard terms and conditions combining both State aid and ESIF criteria

- **3 *de minimis* off-the-shelf instruments:**
  - Risk-sharing loan for SMEs
  - Capped portfolio guarantee
  - Renovation loan for residential buildings

- **2 GBER instruments:**
  - Co-investment Facility
  - Urban development funds

Notification

FIs which fall outside the GBER need to be notified to Commission for ex-ante clearance.

State aid compatibility assessed:

A. under relevant guidelines (e.g. Risk Finance Guidelines)

B. if not covered by the guidelines, directly on the basis of TFEU, assessment based on analogy (e.g. JESSICA cases, SA.33683 - Big Society Capital)

National Promotional Banks

- Under State aid law, NPBs are financed / supported by the State, their interventions are considered in most cases State resources

- Recent Commission decisions on NPBs:
    - British Business Bank – SA.36061
    - UK Green Investment Bank – SA.33984
    - Portuguese Development Finance Institution – SA.37824
    - Latvian Single Development Institution – SA.36904
    - Malta Development Bank – SA.39793
    - CDC Ixis – E 50 / 2003
    - State guarantee for public banks in Germany – E 10 / 2000

ESIF contribution to central FIs

- ESIF contribution does not have to comply with State aid laws when contributed to a centrally-managed FI
- Instead of compatibility, State aid consistency applies, i.e. rules of the central FI
- Condition: Member State does not impose any additional conditions as to the use of the contributions other than in relation to the geographic area
- SWD (2017) 156 final

Takeaway:
think of State aid at start

"State aid legal base determines the entire design of Financial Instrument"

- Eligibility criteria
- Maximum amount per final recipient
- Minimum private investment
- Financial parameters
- Governance parameters

Resources and more information

- Notice on the Notion of Aid (OJ C 262, 19.7.2016)
- Reference Rate Communication (OJ C 14, 19.1.2008)
- Guarantee Notice (OJ C 155, 20.6.2008)
- De minimis Regulation 1407/2013 (OJ L 352, 24.12.2013)
- General Block Exemption Regulation 651/2014 (OJ L 187, 26.6.2014)
- Risk Finance Guidelines (OJ C 19, 22.1.2014)
- Commission Guidance on the European Structural and Investment Funds and European Fund for Strategic Investments complementarities, Ensuring Coordination, Synergies and Complementarity, Feb 2016: http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/efsi_esif_compl_en.pdf
- Commission Staff Working Document : Guidance on State aid in European Structural and Investment (ESI) Funds Financial Instruments in the 2014-2020 programming period, SWD (2017) 156 final, 2.5.2016
- https://ec.europa.eu/transparency/regdoc/rep/10102/2017/EN/SWD-2017-156-F1-EN-MAIN-PART-1.PDF
- European Investment Advisory Hub : www.eib.org/eiah
- *fi-compass*: https://www.fi-compass.eu/

Thank you!

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ESF

financial instruments
revolving
capacity building
added value
ERDF
funding agreement
governance
ESF
EU guidance
ex-ante assessment
technical support
seminars
leverage
financial intermediaries
microfinance
co-financing
case studies
investments
ESIF
fi-compass
final recipients
business plan
Thank you
thematic objectives
advisory services
guarantees
banks
loans
EaSI
equity
EAFRD
private investors
life cycle
combination of support
conferences
factsheets
fund of funds
EMFF
investment strategy
CF
managing authorities
manuals

European Commission

European Investment Bank
The EU bank

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Brainteaser on State aid & ESF Financial Instruments

Question 1

- A Managing Authority is supporting learning, vocational education and training on information and communication technologies for unemployed, with the view that they can re-enter the labour-market with the new skills. The Managing Authority will use ESF resources to create a financial instrument. The participating persons can choose the training they want from the market and take a loan by a commercial bank participating in the financial instrument to pay the educational fee. The Managing Authority will offer an 80% guarantee to the participating banks on a loan-by-loan basis, and undertakes to fully absorb 40% of the first losses, i.e. will pay instead of the natural persons where they cannot, up to the first 40% volume of loans. The banks don't have to pay for the guarantee. In exchange for the guarantee, the participating banks shall undertake to pass on any advantage in the guarantee in the form of lower the interest rate on the loans to the natural person borrowers. The banks will be selected via a competitive selection.

Brainteaser on State aid & ESF Financial Instruments

Answer 1

Please consider which of the following statements apply the best to the State aid position. There is one correct answer:

1. Since the final recipients are natural persons, the programme is outside the scope of State aid law, which only applies to undertakings.

2. As these educational and training courses usually cost less than EUR 200,000, the financial instrument is compliant with the *de minimis* Regulation. Therefore, there is no State aid.

3. Since the participating banks have to provide the loans from their own resources, which are not State resources, State aid law does not apply to the programme.

4. Since the guarantee is free, it contains State aid to the banks, i.e. has to comply with State aid laws. The financial instrument has to be notified to the Commission.

5. **Since the banks have to pass on all the advantages in the guarantee, the banks don't benefit of State aid. Since natural persons are outside the scope of State aid law, they don't benefit of State aid. Thus, the programme does not contain State aid.**

Brainteaser on State aid & ESF Financial Instruments

Question 2

- A Managing Authority is promoting a financial instrument to support SMEs that undertake to employ a certain number of job-seekers or inactive people, including long-term unemployed and young people who would be first-time employed. The Managing Authority will use ESF resources to create a financial instrument providing preferential loans of up to EUR 100,000 to the qualifying SMEs via banks. The banks will be selected through a competitive process and required to provide co-financing from their own resources. To encourage interest and increase the amount of private sector funding leveraged, it is proposed to offer the banks a preferential return on their co-financing.

Brainteaser on State aid & ESF Financial Instruments

Answer 2

Please consider which of the following statements apply the best to the State aid position. There is one correct answer:

1. Since the final recipients are natural persons who would become employed, the financial instrument is outside the scope of State aid law, which only applies to undertakings.

2. As the financial instrument will provide loans of up to EUR 100,000, any aid received by a SME will be below the *de minimis* level. Therefore, there is no State aid in the programme.

3. The proposed instrument uses ESF resources, which is an initiative of and funded by the European Union. Since centrally-managed financial instruments do not qualify as State resources because they are not imputable to a Member State, the ESF funding is not subject to the State aid rules.

4. There is no aid to participating financial intermediaries since no bank would provide similar loans to SMEs conditioned on employing people at disadvantage, so there is no distortion of competition.

5. The preferential return may constitute State aid to the banks. In order to ensure the financial instrument is State aid compliant, it must seek to comply with the requirements of the General Block Exemption Regulation or be notified.

Brainteaser on State aid & ESF Financial Instruments

Question 3

- A Managing Authority wants to support women setting up their business. The Managing Authority will use ESF resources to create a financial instrument that provides a capital contribution of maximum EUR 100,000 per new company. It is proposed that a private risk capital fund will be selected through a competitive process and required to provide a matching equity contribution from its own resources. The financing from the venture capital fund and the ESF will bear the same risks and rewards.

- The participating women have to follow a free training on basic entrepreneurship and financial knowledge provided by a university. The university has been directly appointed. The fee is not paid by the women but by the Managing Authority to the University. The value of the training is EUR 5,000 per person.

Brainteaser on State aid & ESF Financial Instruments

Answer 3

Please consider which of the following statements apply the best to the State aid position. There are several correct answers:

1. Since the private co-financing by the venture capital fund will be 1:1 and on the same terms as the ESF contribution, there is a *pari passu* financing between public and private funds, hence the financial instrument part of the programme is market-conform and contains no State aid.

2. It has to be verified whether the university is overcompensated, i.e. benefits of State aid, by benchmarking the fee they charge to similar training courses available on the market.

3. The university is not benefiting of State aid as it is not an undertaking, and State aid law only applies to undertakings.

4. The free training is a small part of the financial instrument so should follow the same State aid assessment as the financial instrument part of the programme.

5. The free training is a grant that should comply with the *de minimis* Regulation

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Thank you

financial instruments
revolving
capacity building
added value
ERDF
funding agreement
governance
ESF
EU guidance
ex-ante assessment
technical support
seminars
leverage
financial intermediaries
microfinance
co-financing
case studies
investments
ESIF
fi-compass
final recipients
business plan
thematic objectives
advisory services
guarantees
banks
loans
EaSI
equity
life cycle
EAFRD
private investors
combination of support
conferences
factsheets
fund of funds
EMFF
investment strategy
CF
managing authorities
manuals

European Commission

European Investment Bank The EU bank

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