fi compass ESF

advancing with ESIF financial instruments

European Social Fund financial instruments and State aid

European Commission

European Investment Bank The EU bank

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Abbreviations

Abbreviation	Full name
CPR	Common Provision Regulation
EC	European Commission
EIB	European Investment Bank
EIF	European Investment Fund
ESF	European Social Fund
EU	European Union
ESIF	European Structural and Investment Funds
GBER	General Block Exemption Regulation
GGE	Gross Grant Equivalent
TEFU	Treaty on the Functioning of the European Union
TO	Thematic Objective

1. Why is State aid compliance relevant for ESF financial instruments?

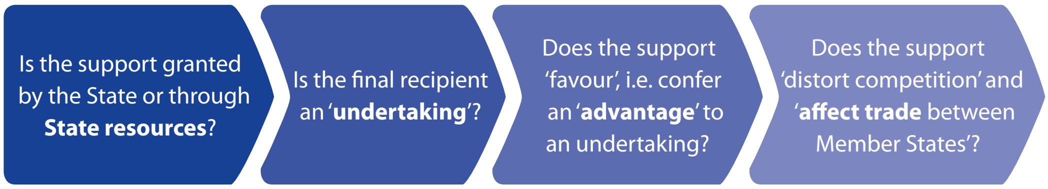
Whenever public authorities provide funding to support economic activities, care has to be taken to ensure that it complies with European Union (EU) rules on State aid. The Treaty on the Functioning of the European Union (TFEU)[1] contains a general prohibition of State aid, except for those cases deemed essential for the well-functioning of the internal market. European Social Fund (ESF) managing authorities implementing financial instruments should ensure State aid compliance at all levels of the implementation.

State aid can be present in many forms of support – not only grants or exemptions, but also financial instruments in the form of loans, guarantees or equity investments. In the case of ESF, financial instruments typically provide microfinance[2] but could include also personal loans.[3] Financial instruments may contain State aid if there is an advantage awarded to undertakings on a selective basis by national public authorities through State resources. For example, a social enterprise[4] being a final recipient could gain a distinct advantage over their competitors that could consequently distort or threaten to distort competition and affect international trade. Where financial instruments are offered to economic activities on terms that the market would not offer for example, microloans with interest rates below the market rate – they involve State aid and certain steps must be taken to ensure compliance with EU rules. Moreover, since financial instruments involve different players, State aid may occur at the level of the bodies implementing them – fund managers, financial intermediaries, funds of funds – at the level of co-investors, or at level of final recipients, such as micro enterprises.

According to the European Commission (EC) guidance[5] and based on the Article 107 of the TFEU, in order to conclude that State aid is present, the following commutative criteria should be present: existence of an undertaking; the imputability of the measure to the State, its financing through State resources; the granting of an advantage; the selectivity of the measure; and that it may have effect on competition and trade between Member States. Therefore, to assess the existence of the State aid, a test based on the below steps has to be carried out at all the three levels – bodies implementing financial instruments, co-investors, and final recipients.

1 European Union (2008), Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2008/C 115/01.
2 For more information on microfinance please see *fi-compass* (2016), Financial instruments working with microfinance.
3 For more information on personal loans please see *fi-compass* (2016), Financial instruments working with personal loans.
4 For more information on social enterprises please see *fi-compass* (2016), Financial instruments working with social entrepreneurship.
5 European Commission (2017), Guidance on State aid in European Structural and Investment (ESI) Funds Financial instruments in the 2014-2020 programming period, Commission Staff Working Document, SWD (2017) 156 final p.5.

Figure 1: The four steps to establish the presence of State aid



Article 107(1) of the **Treaty on European Union and the Treaty on the Functioning of the European Union**

In addition, the factsheet includes three different examples that detail the State aid implications at all governance levels, for different financial products: a capped guarantee, microcredits and student loans. The three examples distributed along the factsheet are based on scenarios relevant to the ESF and include calculation methods in line with the EU Regulations.

Non-economic activities

Often, ESF financial instruments are designed to tackle problems of individuals in their capacity of natural persons, i.e. not for their economic activity. This is the case for example of students in need receiving a loan for carrying out studies, or, more in general, disadvantaged people who are at risk of social exclusion, or are socially excluded.

1.1 Is the support granted through State resources?

For the first step, the answer is normally 'yes' since this is always the case for **ESF resources under shared management**[6] where the implementation tasks are delegated to Member States. According to the EC guidance[7], in fact, where ESI Funds and the national public (co-)funding are spent under shared management and where the contributing Member States have discretion as to the use of those resources, they are 'State resources' that are imputable to the State for the purposes of State aid rules. Therefore, financial instruments managed by or under the responsibility of the managing authority are subject to State aid rules.

Union resources managed directly or indirectly by the Union (or by international institutions) with no discretion on the part of national authorities, do not constitute State resources and are not imputable to the State. Therefore, when a managing authority wishes to provide a ESF contribution to the financial instruments set up by the Commission according to the Article 38.1(a) of the CPR[8] – for example, the Employment and Social Innovation (EaSI) programme – it does not constitute State resources as long as Member States do not impose any conditions[9] or criteria as to the use of the funds. Financial support provided through the European Fund for Strategic Investments (EFSI) or by means of EIB Group interventions using its own resources or centrally-managed EU instruments, does not involve State aid within the meaning of the TFEU.

6 EU Regulation No 966/2012 of the European Parliament and of the Council of 25 October 2012, Art. 59.
7 European Commission (2017), Guidance on State aid in European Structural and Investment (ESI) Funds Financial instruments in the 2014-2020 programming period, Commission Staff Working Document, SWD (2017) 156 final p.6.
8 EU Regulation No 1303/2013 of the European Parliament and of the Council of 17 December 2013.
9 Except for the condition that ESF contributions should be invested in the territory of the contributing Member State eligible under the ESF rules.

Figure 2: ESF resources and State aid

ESF resources under shared management Implementation tasks are delegated to Member States	**Considered State resources**
ESF resources to EU level financial instruments Not under the control of the Member States	**Do not constitute State resources**

i **EC Guidance on State aid** in ESIF financial instruments in the 2014-2020 programming period

1.2 Is the final recipient an 'undertaking'?

The presence of State aid requires that State resources are received by an 'undertaking' which is any entity involved in an economic activity irrespective of its legal status, the way it is financed or whether it aims to make a profit. An economic activity is broadly defined as 'offering goods or services on a given market'. There is no definitive list of economic activities, but non-economic activities include those related to State prerogatives and public safety such as police, armed forces, air and maritime traffic control, as well as the organisation of public education and compulsory social security contributions.

In the case of ESF, financial instruments are typically tailored to financially excluded final recipients with high social vulnerability and can be used to finance a range of activities related to job creation, social inclusion, education and social entrepreneurship. ESF resources in fact can be delivered to individuals and to social enterprises or any operators that work in the social economy, for promoting employment under thematic objective 8 (TO 8), supporting social inclusion (TO 9), and investing in education, skills and lifelong learning (TO 10).

As stated above, State aid rules do not apply to aid provided to individuals who are not engaged in an economic activity. For the avoidance of doubt, it is important to recall that vulnerable people as referred to in the European Pillar of Social Rights are not 'undertakings' to which the EU Treaty State aid rules apply.

i **EC Notice on the notion of State aid** as referred to in Article 107(1) of the TFEU

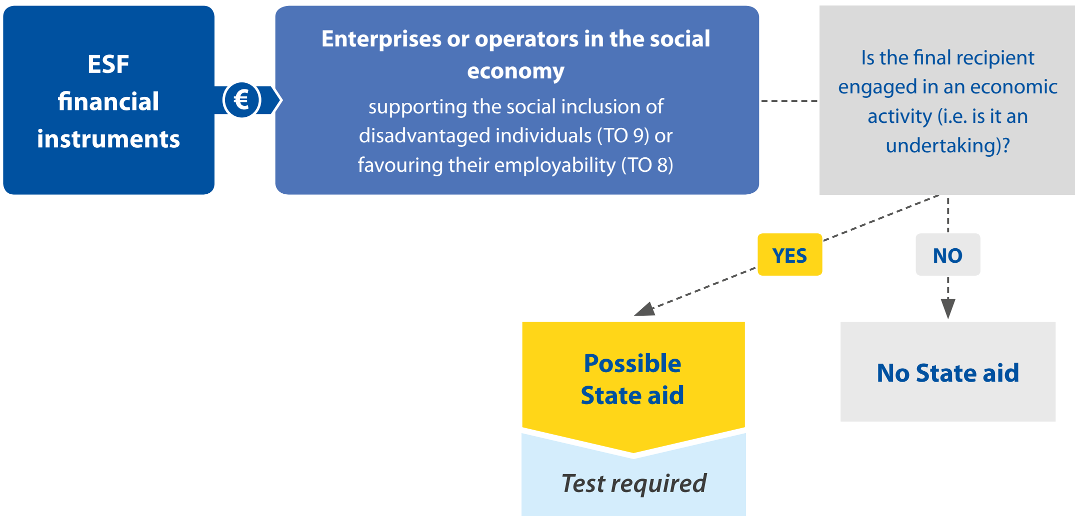
Concerning the support to **social enterprises**, they can be considered as 'undertakings' since the term 'social' is not of itself enough for it to avoid being regarded as an 'economic activity'. It is not necessary in fact to make a profit to be engaged in economic activity. If the social enterprises offers goods or services on a market, it is an economic activity, the social enterprise is considered as an undertaking and State aid rules may apply. In the case of universities/colleges, they are regarded as undertakings where they use public funds to engage in economic activity beyond their public remit. Financial support to public and not-for-profit organisations, such as voluntary, charitable and cultural bodies, are therefore not affected by State aid rules where they are not engaged in an economic activity.

In some cases, social enterprises can be entrusted by the Public Authority to carry out **social services of general economic interest**, i.e. public services. Social services of general economic interest are those that respond to the needs of vulnerable citizens and are based on the principles of solidarity.

Typical cases of social services of general economic interest involve social enterprises that, by means of an agreement with the authorities provide social inclusion activities (health care, food and shelter, social housing, employment of handicapped people and socially excluded or at risk of exclusion, etc.), often at loss.

The providers of those services are typically qualified as undertakings for the purposes of State aid law and the public service compensation they receive from the Public Authority is subject to State aid rules.[10]

Figure 3: ESF financial instruments – social enterprises and potential State aid



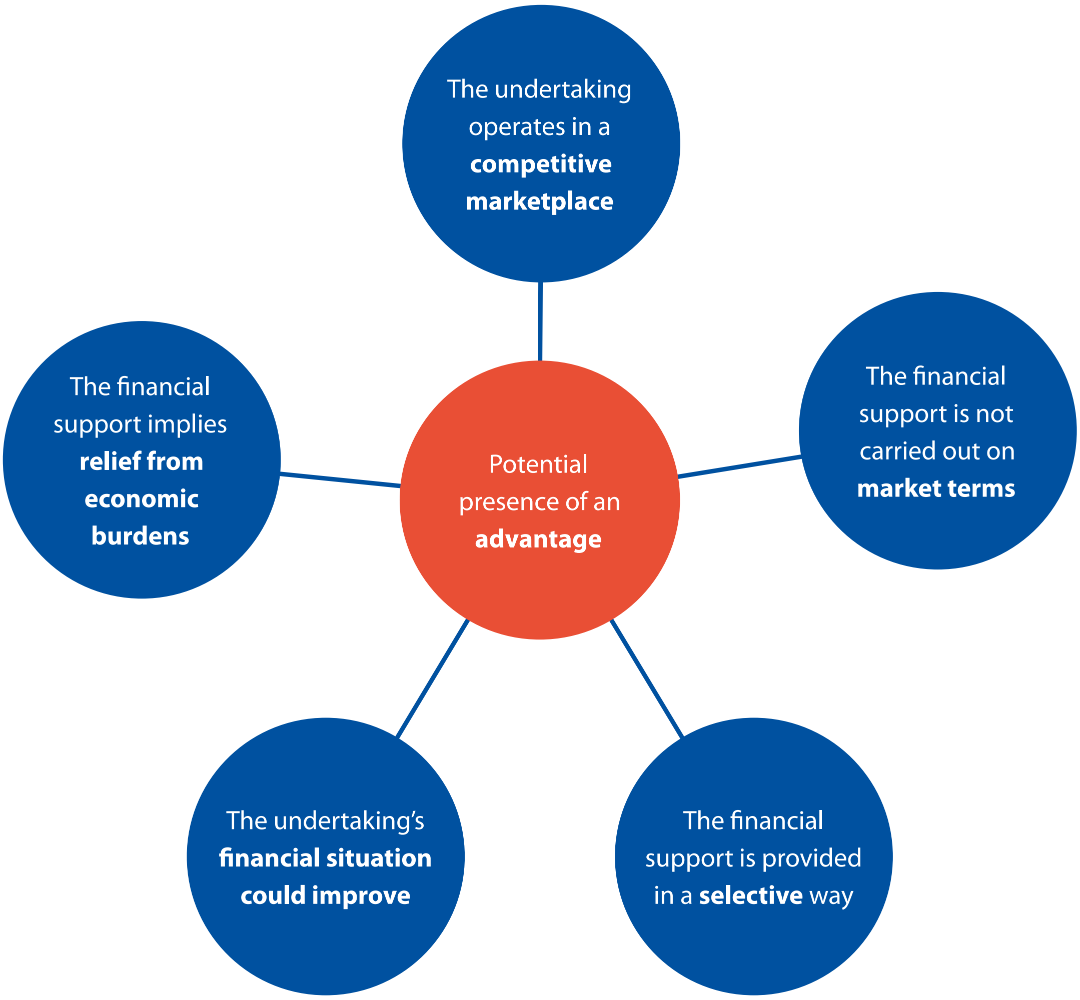
10 Guidance on the State aid rules for Services of general economic interest can be found in: http://ec.europa.eu/competition/state_aid/overview/public_services_en.html.

1.3 Does the measure confer a selective advantage to an undertaking?

An advantage is granted to an undertaking (or a sector) within the meaning of Article 107(1) TFEU if an undertaking (or a sector) receives an economic benefit which it would not have obtained under normal market conditions (i.e. in the absence of State intervention).[11]

The precise form of the measure is also irrelevant in establishing whether it confers an economic advantage on the undertaking. Not only the granting of positive economic advantages is relevant for the notion of State aid, but also relief from economic burdens can also constitute an advantage.[12]

Figure 4: Elements to consider when assessing if a measure confers an advantage on the undertaking



Source: Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union

11 Case C-39/94, Judgment of the Court of 11 July 1996 – Syndicat français de l'Express international (SFEI) and others v La Poste and others, para. 60.
12 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, para. 67, 68.

In order to constitute State aid, the advantage must be **selective** in that it favours certain undertakings or the production of certain goods. Therefore, State aid measures are distinct from general economic, tax or social policy measures, which are effectively open to all undertakings operating in a Member State on an equal basis.

As explained by the Commission Notice on the notion of State aid, to assess the potential presence of an advantage for an undertaking compared to others in the market, the financial situation of the undertaking following the measure should be compared with its financial situation if the measure had not been taken (i.e. to verify whether the undertaking's financial situation has improved). This could be done by benchmarking the costs of the project against the typical costs for such a service on the open market.

1.4 Does the measure distort or threaten to distort competition and have the potential to affect trade between the Member States?

If the support has the potential to strengthen the position of a certain undertaking relative to other competitors, then this criterion is likely to be met. The potential to distort competition does not need to be significant or material, and this criterion can apply also to relatively small amounts of financial support and undertakings with little market share. State aid is almost always presumed to have a potential effect on competition when the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition. In markets where no competition is possible, for instance in the case of an activity which is reserved for a monopoly designated by law, distortion of competition is normally excluded.

Concerning the effect on trade, the EC's interpretation of this is broad – it is sufficient that a product or service is tradeable between Member States, even if the recipient of support does not itself export to other EU markets, operates only at local level or has a small share on any relevant market. The final recipients in fact may compete to some extent in trade with other EU undertakings which do not benefit from the scheme and the advantage given to the final recipients could thus have, at least theoretically, a certain impact on trade between Member States.

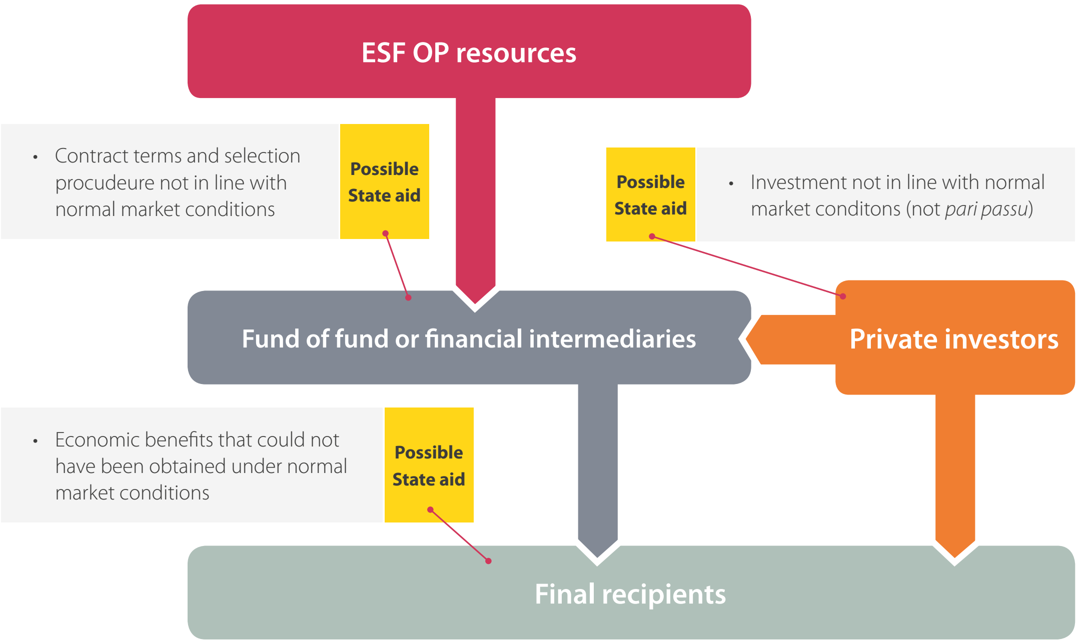
Figure 5: Elements to consider when assessing if a measure can be considered as not affecting trade between the Member States

Source: Commission's Decisions in cases N 258/2000 (Germany, leisure pool Dorsten), N 486/2002 (Sweden, Aid in favour of a congress hall in Visby), N 610/2001 (Germany, Tourism infrastructure program Baden-Württemberg), N 377/2007 (The Netherlands, Support to Bataviawerf — Reconstruction of a vessel from the 17th century).

2. When does State aid happen?

State aid may be present at different levels and compliance with the State aid rules at the final recipient level, in the context of financial instruments, is not enough. The State aid legal base determines the entire design of the financial instrument and needs to be chosen from the outset as it determines the eligibility criteria, maximum amount per final recipient, minimum private investment, other financial and governance parameters.

Figure 6: Different levels of potential State aid



2.1 State aid at the level of the fund of fund or financial intermediaries

Financial instruments transactions involving direct transfers to or co-investment by a financial intermediary may involve State aid at the level of the fund of fund or the financial intermediary unless they are made on terms which would be acceptable to a normal market operator in a market economy.

Where the State delegates the implementation of a financial instrument to a financial intermediary which acts on its behalf as an **entrusted entity**[13], without that entity co-investing alongside public funds, the entrusted entity would not be a recipient of aid as long as it is acting within its public remit under the instrument.[14] However, where entrusted entities provide funding from own resources to the fund or financial instrument or co-invest in a manner similar to financial intermediaries, they may be State aid recipients.

As a general principle, where a financial intermediary takes the form of a fund with a separate legal entity and is managed by a third-party manager, the EC considers that the fund is just a vehicle for the transfer of aid to enterprises in which the investment is made, rather than being in a receipt of aid in its own right. Investors in the fund and the fund manager may be recipients of aid.

Bodies implementing financial instruments (fund managers, financial intermediaries, funds of funds) may be recipients of State aid if the remuneration for the services or reimbursements to implement the financial instrument exceeds market rates. However, if a fund manager is chosen through a competitive, transparent, non-discriminatory and unconditional selection procedure, its remuneration is presumed to be in line with market rates.[15] In the absence of an open, transparent, non-discriminatory and objective selection procedure, market conformity of the remuneration for the management services needs to be assessed to establish if it fully reflects the current market level in comparable situations.

Where the **financial intermediary and its manager are public entities** and were not chosen through an open, transparent, non-discriminatory and objective selection procedure, the above principle applies and some further criteria: (i) their management fee is capped; (ii) their overall remuneration reflects normal market conditions and is linked to performance.[16] In addition, public financial intermediaries must be managed commercially and their managers must take investment decisions in a profit-oriented manner at arm's length from the State. Private investors must be selected through an open, transparent, non-discriminatory and objective selection process on a deal-by-deal basis.

13 This means 'the European Investment Bank, the European Investment Fund, an international financial institution in which a Member State is a shareholder, or a financial institution established in a Member State aiming at the achievement of public interest under the control of a public authority, a public law body, or a private law body with a public service mission'; entrusted entities can be selected or directly appointed in accordance with the relevant public procurement directives.

14 If the remuneration is aligned with the Articles 12 and 13 of Delegated Regulation (EU) No 480/2014 and no other advantages are granted by the State, as in Regulation 964/2014.

15 European Commission (2017), Guidance on State aid in European Structural and Investment (ESI) Funds Financial instruments in the 2014-2020 programming period, Commission Staff Working Document, SWD (2017) 156 final p.12.

16 Capping of fees is provided for in Regulation 480/2014 as are criteria for determining performance related management costs and fees.

Example 1 – Capped Guarantee for social inclusion

In a region affected by increasingly turbulent economic environment, social enterprises are faced with a poor access to credit from commercial lenders. In order to achieve the objective of social inclusion and combat poverty (TO 9), the managing authority implemented a guarantee scheme to support individuals involved in creating new ventures for social purposes, who lack the collateral to obtain necessary finance. The implementation was entrusted (Article 38 of the CPR) to an International Financial Institution (IFI) acting as a fund of funds manager and a guarantor to the selected financial intermediaries (separate funding agreements with each one). The IFI does not provide financing directly to social enterprises, but offers capped guarantees to financial intermediaries, which in turn disburse newly originated loans to the final recipients.

Financial intermediaries shall be selected by the IFI on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflict of interest. The capped guarantee provides risk coverage to each participating financial intermediary on a portfolio of new loans up to EUR 100 000, with a rate of 80% on a loan-by-loan basis up to a cap of 25% of the portfolio. The guarantees are issued free of charge (e.g. no guarantee fee), and the financial advantage which is transferred completely to final recipients. The financial size of the guarantee fund is EUR 20 million.

At fund of funds level the IFI is remunerated within the limits set by the CPR. The guarantee is free of charge to financial intermediaries and the full financial advantage is passed on to the final recipients in the form of reduced interest rate and/or collateral requirements on the loans. Therefore, there is no State aid at the level of the financial intermediary.

The State aid is present at final recipients' level, as they are undertakings in the sense of Article 107 of the TFEU and receive an advantage they would not obtain under normal market conditions in the form of sub-commercial borrowing terms.

2.2 State aid at the level of private (co-)investors

An investment under the financial instrument will be presumed to be in line with normal market conditions if it is done on a *pari passu* basis between public and minimum 30% private investors[17]; this means that there is no aid to private investors and no aid downstream at the level of the final recipients. For these purposes, the term 'private investors'[18] means a private operator acting under normal market conditions and will typically include inter alia the European Investment Bank (EIB) Group, commercial banks investing own resources at own risk, private endowments and foundations, family offices and business angels, corporate investors, insurance companies, pension funds, private individuals and academic institutions.

17 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, section 4.2.3(i).

18 Ibid., footnote 25.

An investment is considered *pari passu* when public and private investors must invest on the same terms and conditions and the intervention of the private sector must be economically significant. This means that:

- The public and private investor **share the same risks and rewards** and hold the same level of subordination in the same class of investment.
- Public and private investors **invest at the same time**. This is assumed to be so where investments are made through public-private financial intermediaries. Where co-investment is at the level of the individual project or enterprise, this must be done through the same investment transaction.
- The funding provided by the private investor must be **economically significant**, defined as at least 30% of the overall volume of the investment.

Note that if an investment fund is run on *pari passu* terms as outlined above, investments by that fund in target enterprises (i.e. final recipients) are not considered to involve State aid either because they are on market terms.

EC Communication **'Guidelines on State aid to promote risk finance investments'**

In the absence of private co-investors on *pari passu* terms, which provide direct evidence of market conformity, the financial instrument's conformity with market condition needs to be assessed through benchmarking or other methods.

Example 2 – Microcredit to support self-employment and small business creation

Since the financial crisis, a region has recorded a very high unemployment rate, most particularly affected were the young (below 24 years old) and the most disadvantaged groups (women, migrants), adding to the numerous structural problems of the region.

In order to achieve sustainable and quality employment (TO 8), the managing authority chose to implement a region-wide microcredit scheme to support self-employment and small business creation and to facilitate the transition into work of young and disadvantaged people. Based on the results of the ex-ante assessment the managing authority decided to charge a price of 1.33% on ESF part.

For the implementation of the scheme, the managing authority held an open call for expression of interest conducted in accordance with public procurement rules. One Microfinance Institution (MFI), a private entity, was selected to act as the body that implements the financial instrument (Article 38 of the CPR), which committed to contribute 40% of the fund size from its own resources charging a market price.

The MFI disburses microcredits at an advantageous price (combined interest rate lower than market level) plus non-financial services (training and mentorship programmes) to start-ups or micro-enterprises. The non-financial services cover subjects like Accountancy, Management, Labour law and Marketing, and their total value cannot exceed 50% of the microcredit size (i.e. EUR 12 500 in the case of a microloan of EUR 25 000). Instead of the final recipients, the commercial fee for the non-financial services are paid directly by the managing authority to the MFI. The financial size of the microcredit fund is EUR 50 million, with the reimbursed loans being redistributed to new final recipients.

At MFI level, as regards the remuneration for the management services, there is no State aid present, as it was selected in accordance with public procurement rules and the remuneration was subject to the selection. It invests together with the managing authority on *pari passu* terms, sharing the risks and rewards in equal measure on a loan-by-loan basis. Moreover, the portfolio risk-sharing rate of 40% is above the minimum participation rate considered 'economically significant' by EU State aid law (minimum 30%). Therefore, the investment by the managing authority is considered market conform and there is no aid to the co-investor.

However, there is State aid present at the final recipient level, as they are undertakings in the sense of Article 107 of the TFEU and receive an advantage (interest rate lower than market level together with the non-financial services) they would not obtain under normal market conditions.

2.3 State aid at the level of final recipients

As previously underlined, when financial support is provided in a selective way to an undertaking or a sector conferring an advantage, there is State aid. Therefore, the design of the financial instrument including maximum amounts of support as well as the nature of the final recipients (undertaking or not) will play a crucial role in determining whether the final recipient will be considered as aid recipient or not.

Where there is State aid at the level of investors, financial intermediary or its managers, this is generally considered to be at least partly passed on to the target undertakings (i.e. projects or enterprises). Where support is in the form of loans and guarantees (including counter-guarantees) the value of these can be set such that there is no aid to the target investment on the basis of the Communication on the reference interest rate[19] for loans or the Notice for guarantees.[20]

Example 3 – Student loan for disadvantaged groups

To achieve the Operational Programme's objective (TO 10) of improving the quality and efficiency of, and access to, tertiary and equivalent education with a view to increasing participation and attainment levels, especially for disadvantaged groups, the managing authority conducted an ex-ante assessment towards implementing a financial instrument focused on student loans.

The region recorded the highest growth of the high-tech sector at national level over the last five years. However, the region employs almost half of the foreign employees with tertiary education in the country (46%). Moreover, an EU level survey registered in this region the second highest percentage in Europe (64%) of respondents who would continue their education to a higher level, if they had the necessary funding.

Following the results of the ex-ante assessment, the managing authority chose to entrust implementation tasks (Article 38 of the CPR) to the 'in house' financial institution that acts as a financial intermediary and handles the entire process from selection of final recipients until the disbursement and reinvestment of resources.

The financial product offered is loan up to EUR 50 000 that cover only the tuition fee to EU higher learning institutions for final recipients. The interest rate is set at 3% and the repayment period is 10 years. The principal amount can be paid at the end of the repayment period.

Eligible final recipients are students or persons that already possess an undergraduate degree (Bachelor's). The final recipients are eligible to receive the loan only after being officially admitted to a higher-education programme (Master's or PhD) at one of the accredited higher-education institutes or universities in the EU. The financial size of the loan fund is set at EUR 5 million with half of it from ESF and half from the national co-financing. There is no private component.

There is no State aid at financial intermediary level as all the benefits are passed on entirely to final recipients, in the form of below market level interest rate and an extended repayment period.

Likewise, there is no State aid at final recipient level as these are not undertakings, but individuals who are not engaged in an economic activity.

19 Communication from the Commission on the revision of the method for setting the reference and discount rates, OJEU C14/6 of 19 January 2008.

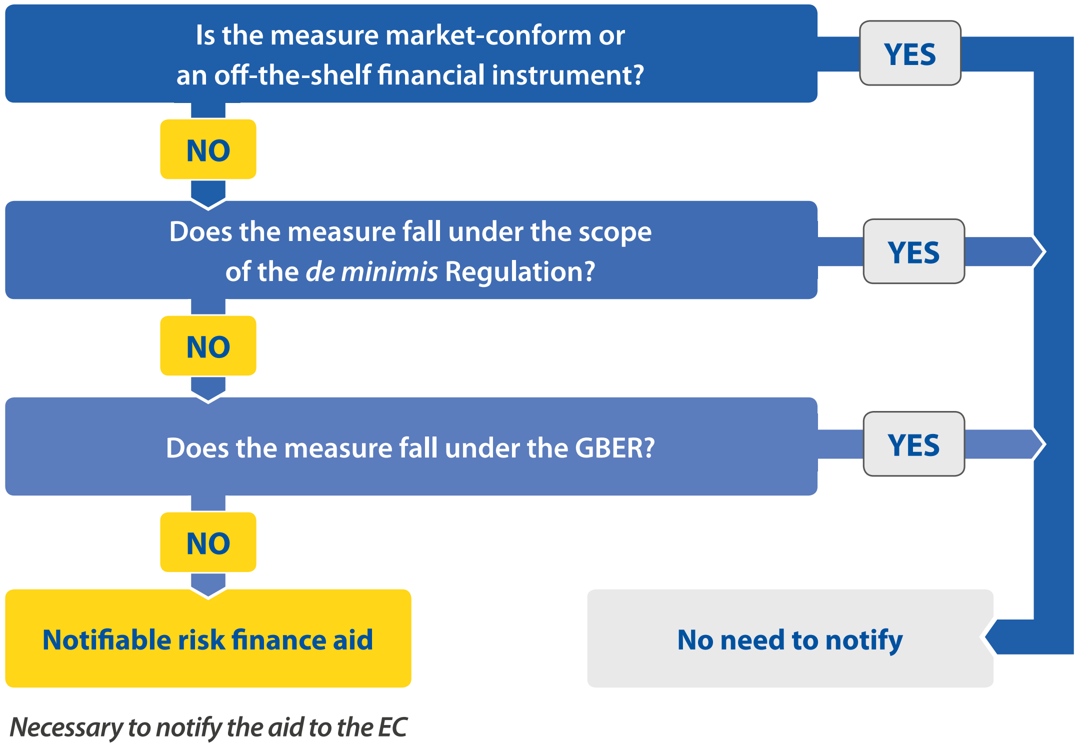
20 Commission Notice on the application of Article 87 and 88 of the EC Treaty (now Article 107 and 108 TFEU) to State aid in the form of guarantees, OJEU C155/10 of 20 June 2008.

3. How to be State aid compliant?

When the measure does not present market-conformity, the State aid rules offer several routes to compliance, beyond eliminating aid, that may be summarised as follows:

- the off-the-shelf instruments[21];
- the *de minimis* aid Regulation[22];
- the rules on provision of services of general interest:
  - SGEI *de minimis* Regulation[23];
  - SGEI Decision[24];
  - SGEI Framework[25];
- the General Block Exemption Regulation (GBER)[26]; and
- the notification of the proposed financial instruments to the EC.

Figure 7: State aid procedures flowchart



21 Commission Implementing Regulation (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments.

22 European Commission (2013), Commission Regulation 1407/2013 on *de minimis* aid, OJEU L 352/1 of 24 December 2013: http://ec.europa.eu/competition/state_aid/legislation/de_minimis_regulation_en.pdf.

23 Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of article 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest, OJ L 114 of 26.4.2012, p. 8.

24 Commission Decision of 20 December 2011 on the application of article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, OJ L 7 of 11.1.2012, p. 3.

25 Communication from the Commission, European Union framework for State aid in the form of public service compensation, OJ C of 11.1.2012, p. 15.

26 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0651&from=EN.

3.1 Off-the-shelf instruments

Compared to and learning from the 2007-2013 programming period, the improved legal framework for the 2014-2020 programming period includes innovations such as the 'off-the-shelf instruments' offering predefined standard terms and conditions including compliance with the relevant State aid regimes (no need for notifications), and the possibility to contribute resources to EU-level instruments.

Five different 'off-the-shelf instruments' have been adopted by the EC, with the **Risk sharing loan for support to SMEs** and the **Capped portfolio guarantee** being more suitable for ESF operational programmes.

Off-the-shelf instruments pros and cons	
+	• Help managing authorities to deliver fast and safer funds to the final recipients • Full compliance with State aid and/or the *de minimis* aid rules
–	• They can be scarcely used in the ESF, due to the specific needs of the target groups

3.2 The *de minimis* aid Regulation

The second method to compliance with the internal market, is to design the financial instrument so that compliance with the *de minimis* aid Regulation, including that the undertaking has received support totalling less than EUR 200 000 in any three-year period.[27] In case of financial instruments the aid is granted in a form other than a grant, hence the aid amount shall be the gross grant equivalent (GGE) of the aid.[28]

The *de minimis* aid option is useful where the final recipients are undertakings and the financial instrument is not market conform. It is based on the assumption that small amounts of support do not have a significant impact on competition and trade in the European Economic Area (EEA) and therefore do not involve State aid. For *de minimis* aid, the awarding body must check that the threshold is not breached, and the final recipient must be informed that support is provided on the basis of the *de minimis* aid Regulation.

De minimis aid applies to any undertaking, including financial intermediaries. Therefore, in order for the financial instrument to fall under the *de minimis* aid Regulation, aid at the level of financial intermediaries have to be either below the *de minimis* aid ceiling or excluded, in which case there has to be a mechanism to fully pass on the aid to the final recipients.[29]

27 The amount of the aid if it had been provided in the form of a grant to an undertaking before any deduction of tax or other charge.

28 The different methods of calculating the GGE are foreseen in Article 4 of the *de minimis* aid Regulation.

29 Recital (19) of the *de minimis* aid Regulation.

Based on the cumulation rules, where the relevant ceiling would be exceeded by the grant of new *de minimis* aid, none of the new aid may benefit from the *de minimis* aid Regulation. This means that if an application is received which would result in the ceiling being exceeded, *de minimis* aid cannot be awarded in whole or in part, even if a partial award would not result in the ceiling being exceeded.[30]

de minimis aid pros and cons	
+	• Fast implementation enables small amounts of support to 'avoid' having to comply with more complex State aid rules • Broad eligibility criteria • Amounts are not calculated as percent of project cost, but subject to the financial ceiling and the cumulation rules
–	• Requires declarations or a national database to track amounts of *de minimis* aid received • Needs special attention how to capture *de minimis* aid at the financial intermediary level and where relevant ensure a full pass on of the aid • Amount is limited (more so if a recipient has already had some *de minimis* aid) so may not cover financing needs of the investments

i **Commission Regulation (EU) No 1407/2013** – *de minimis* aid

Example 1 – Capped Guarantee for social inclusion

Final recipients have to be informed of the amount of *de minimis* aid granted and the GGE of the aid has to be calculated to ensure that it is in accordance with, and below the threshold of the *de minimis* aid Regulation.

In order to apply the *de minimis* aid Regulation[31], it is necessary to calculate precisely the GGE of the aid ex-ante without any need to undertake a risk assessment – 'transparent aid'.

In case of example 1 and in accordance with Article 4(6) of *de minimis* aid Regulation, for a guarantee that does not exceed 80% of the underlying loan and the amount guaranteed is lower than EUR 1 500 000 and the duration of the guarantee is five years, the GGE of the aid shall be calculated as a corresponding proportion of the *de minimis* aid ceiling (EUR 200 000) laid down in Article 3(2).

$$\text{GGE} = \frac{\text{Amount guaranteed}}{\text{EUR 1 500 000}} * \text{EUR 200 000}$$

GGE of the aid (for a guaranteed loan of EUR 100 000) = (80 000 / 1 500 000) * 200 000 = **EUR 10 667**

30 Article 3(7) of the *de minimis* aid Regulation.
31 In addition, the final recipient of the guaranteed loan must also not be subject to collective insolvency proceedings nor fulfil the criteria under its domestic law for being placed in collective insolvency proceedings at the request of its creditors. In case of large undertakings, the beneficiary shall be in a situation comparable to a credit rating of at least B- (Article 4(6)(a) of Commission Regulation (EU) No 1407/2013).

Example 2 – Microcredit to support self-employment and small business creation

Since there is aid present at final recipients' level, they must be informed that they are receiving aid under *de minimis* aid Regulation. An indicative example of calculating the GGE of the aid received from the microcredit scheme is shown in the table below.

A loan of EUR 25 000 at an interest rate of 3% and with a duration of five years (with a three-year grace period) to an eligible final recipient. As a private operator, the financial intermediary charges for the loan the market price of 5.5% (annual interest rate) for its co-investment part (40%), in relation to the credit worthiness and collateral provided by the final recipient. Alternatively, the managing authority charges a price of 1.33% on its part (60%). The difference between the market-level interest rate and the (lower) interest rate offered by the ESF financial instrument represents the aid component. Assuming a discount rate of 0.82%[32] and non-financial services equivalent to EUR 12 500 (maximum allowed under the scheme's terms and conditions) received during the first year, the aid component can be quantified as follows:

$$GGE = \sum \frac{P_t * (r_m - r) + NFS_t}{(1+i)^t}$$

Where:

P_t = the principal of the loan for year t;

r_m = market interest rate;

r = yearly interest rate of the loan;

NFS_t = estimated value of the non-financial services related to the loan for year t;

i = discount rate calculated in accordance with the Reference rates Communication.

Year	Calculation	Non-financial services provided	GGE of the aid (including non-financial services)
1	(€25 000 * 0.025 + €12 500) / 1.0082^1	€ 12 500	€ 13 018,25
2	€25 000 * 0.025 / 1.0082^2	€ 0	€ 614,87
3	€25 000 * 0.025 / 1.0082^3	€ 0	€ 609,87
4	€16 667 * 0.025 / 1.0082^4	€ 0	€ 403,28
5	€8 333 * 0.025 / 1.0082^5	€ 0	€ 199,99
		GGE of the aid (Total)	**€ 14 846,27**

32 Calculated in accordance with the Commission communication of 19.01.2008 http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html.

3.3 The General Block Exemption Regulation

Another option to design a State aid compliant financial instrument is to fit within a General Block Exemption Regulation (GBER).[33] The overall aim of the GBER is to obviate the need for notification of aid to the EC and its approval in advance of implementation. Instead, for certain categories of aid[34], compatibility is presumed, provided that specified conditions are met, and the monitoring and reporting requirements are fulfilled.

Where a managing authority opts to design a financial instrument in line with the GBER, this must be reported to the EC within 20 working days of the start of the implementation and several requirements related to reporting, monitoring and transparency must be met.

GBER exemptions

The GBER exempts a wide range of State aid measures from prior notification and approval, among which the following could be considered as most relevant for ESF financial instruments:

	Article 21 – Risk finance aid	Article 22 – Aid for start-ups
Advantages	• covers aid at the entire intervention chain (financial intermediaries, private co-investors, final recipients) • fast implementation	• higher amounts than de minimis aid
Disadvantages	• the purpose is to support fast-growing innovative companies, which may not suit the social sector	• does not cover aid at the financial intermediary level, i.e. aid has to be fully passed on

General and specific conditions apply to each category of aid.

A number of general conditions must be met for aid to comply with the GBER. These are in addition to the specific conditions relating to individual categories of aid. In particular:

- **Transparency**: it must be possible to calculate beforehand the GGE of the aid where aid is not offered in the form of a grant, except for Articles 16, 21 and 39. Specific conditions apply to different types of financial instrument regarding transparency.
- **Incentive effect**: applications for support must be made before work starts; there are more onerous requirements for demonstrating incentive effect in the case of ad hoc aid to large enterprises.

33 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the TFEU.
34 The GBER contains 46 State aid exemptions which can be used to lawfully award State aid; however, not all 46 exemptions are suited to financial instruments.

- **Cumulation**: notification thresholds and aid intensities must be respected – these vary by category of aid. However, *de minimis* aid can be combined with aid based on the GBER, provided that cumulation would not result in the relevant aid ceiling or notification threshold from that category of aid being exceeded.

GBER pros and cons	
+	• Compatible aid • Enables relatively generous levels of aid across a range of policy areas • No delays in implementation as no notification required
–	• Onus is on national authorities to ensure compliance • Some aspects of the rules may be complicated • Eligibility criteria may not fit the social sector

i **Commission Regulation (EU) No 651/2014** – General Block Exemption Regulation (GBER)

3.4 The notification

A final route to compliance with State aid rules is to notify the proposed financial instruments to the EC: where financial instruments are thought to contain State aid but do not meet the requirements of the *de minimis* aid Regulation or fit within the GBER, they must be notified to the EC who will reach a decision on compatibility within a period of two months from complete notification. Notified aids cannot be implemented until the EC has approved them.

The basis for its approval will vary according to the findings of the preliminary investigation and to the completeness of information provided by the notifying Member State. Since there are no dedicated State aid guidelines for socially-oriented financial instruments that may face different market failures from SMEs in general, approval by the EC directly under the Treaty provisions by analogy to the Risk Finance Guidelines could be considered as most relevant for ESF financial instruments. However, the Risk Finance Guidelines could also be appropriate for certain financial instruments.

In case of a complete notification, the EC can decide that the measure can be implemented because (i) it does not constitute State aid, or (ii) the aid is compatible with EU State aid rules and thus the internal market. However, if there are serious doubts about the compatibility of the notified measure, the EC will open a formal investigation procedure, preventing the implementation of the measure until an in-depth investigation will have been concluded.

Notification pros and cons	
+	• Approval by the EC gives legal certainty that proposed aid is compatible with the internal market • Terms potentially more generous than *de minimis* aid or GBER allow, enabling more 'tailor-made' aid
–	• The notification process may be lengthy and the outcome uncertain

3.5 What if...

If the proposed aid does not fit within any of the compliance options – or if the managing authority is unsure whether aid is involved, a proposed financial instrument can be notified to the EC, but it cannot be implemented until the EC approves it.

Aid granted without prior EC authorisation is called **unlawful aid**. Same as with notified aid, the EC first opens a preliminary investigation and, if doubts about the compatibility of the measure persist, subsequently carries out an in-depth investigation. The EC may use injunctions to obtain information, suspend the further granting of aid or impose provisional recovery obligation on the Member State.

Should a negative decision be reached, and the aid has already been paid out, the Member State must **recover the aid** (with interest) from the final recipient, unless such recovery would be contrary to a general principle of EU law. If the Member State fails to comply with the decision in due time, the EC may refer the case to the European Court of Justice.

The aim of recovery is to remove the undue advantage granted to certain undertaking(s) and to restore the market to its initial state, before the aforementioned aid was granted. There is a limitation period of 10 years for recovery, after which no recovery can be ordered.

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