

Guarantee instruments and State Aids



Guarantee instruments and
Community rules and
constraints on State Aid

Introduction: The “GO Network Project” and the Institute for the Industrial Promotion



IPI provides support to the Region Veneto on the field of State aid and the guarantee instruments through its activity in the project “Go Network”

More in detail:

I ° part of the work: (realized)

The IPI study aims at illustrating the EC rules and constraints, by examining the theme of the guarantee instruments within the European Union, in accordance with the Community rules on State Aid, by highlighting the main difficulties involved in elaborating Aid Schemes in the form of guarantee

II ° part of the work: (at work)

The IPI study aims at illustrating the main features of some guarantee instruments playing in the following countries:

- Italy;
- Poland;
- Austria;
- Czech Republic

State Aid: basic rules ...



Article 87 of the E.U. Treaty:

- state aid definition
- incompatibility with common market
- derogations

Article 88 of the Treaty:

- Obligation of notification
by Member States

- **1) Transfer of State resources:**

- State aid rules cover only measures involving a transfer of State resources (including national, regional or local authorities, public banks and foundations, etc.)

- **2) Economic advantage:**

- The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business.

- **3) Selectivity:**

- State aid must be selective and thus affect the balance between certain firms and their competitors. Selectivity is what differentiates State aid from so-called “general measures”.

- **4) Effect on competition and trade:**

- Aid must have a potential effect on competition and trade between Member States. It is sufficient if it can be shown that the beneficiary is involved in an economic activity and that he operates in a market in which there is trade between Member States.

Guarantee instruments and State Aids



Firstly, we remind you that **the guarantee can be used as an Aid**, alternatively with other instruments, such as : soft lending, financial support or tax exemption ...

But when can we define a guarantee a State Aid, too?

Within the analysis carried out to establish if the State measure actually requires support to favour certain business or productions, the Guarantee presents some peculiarities unlike other forms of Aid ...

(These peculiarities chiefly concern the need of determining and quantifying the economic advantage)

This feature has been examined in the first part of the IPI report

And also ...

State measures aimed at granting guarantees, sometimes require the creation of funds and/or of interventions from various subjects ...



... In this respect, the analysis of the Aid scheme implies some difficulties relating to the identification of the beneficiary subject, as well as to Commission approach on the possible Aids addressed to various subjects involved.

This feature has been examined in the second part of the IPI report

About the Notice on Guarantees, we must remember ...

On the basis of a consultation document entitled: *State aid action plan - Less and better targeted state aid: a road map for state aid reform 2005-2009*, adopted on 7 June 2007, the Commission pledges to review the notice on Guarantees, in order to integrate the experiences gained and decide whether amend the current rules and criteria. This review is expected between 2007 and 2008. The Member States and Third Countries interested will be requested to submit their comments.

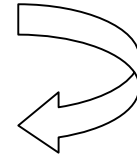
Determining the benefit

The key matter is the calculation of the benefit at a borrower level

Actually, as shown in the second part of this study, guarantees in some cases may provide for the presence of Aid to various subjects.

The analysis aimed at verifying the presence or not of a benefit for a certain subject (investor, guarantee fund, guarantee fund manager, borrower, lender etc.) can therefore become rather complex.

[(s. the next slides)]



When a public Authority does not award a guarantee to a private investor on easy terms, the measure constitutes an Aid, because of the presence of the benefit for the business (the borrower, in accordance with the Notice on guarantees).

The aid element (or benefit) of a guarantee is that the risk associated with the guarantee is carried by the Member State (no credit payments are made by the borrower).

It is necessary to verify the occurrence of the other Three conditions required by the Article 87(1) of the Treaty ar. 1!

The benefit: determining the “Risk factor or coefficient” becomes a key element



More in detail, it can be easily identified as

***the difference between
the interest rate applied for the loan obtained by the borrower
through a State guarantee
and
the one which should be obtained in the absence of guarantees***

To this value should be however deducted the price paid for the guarantee.

Hence, it follows that, if the sum paid corresponds to an equitable return on risk factor (or rather covers the difference between the two interest rates), the guarantee does not produce any benefit for the borrower

Determining the benefit – method of calculation of the grant equivalent

Individual Aid

The standard form of calculation should be as follows:

"...the same way as the grant equivalent of a soft loan, the interest subsidy representing the difference between the market rate and the rate obtained thanks to the State guarantee after any premiums paid have been deducted"

Aid Scheme

The standard form of calculation should be as follows (even if these two methods are interchangeable):

"the grant equivalent can be taken to be the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor (the probability of default) and (b) any premium paid, i.e. (guaranteed sum \times risk) - premium"

$$GE = Sg \cdot R - P$$

Besides these methods of calculation, the Commission aims at evaluating any other objectively justifiable and generally accepted method, in the notification phase of the measures .

The percentage is set by 20%.
See point 3.4 of the Notice on Guarantee

also other conditions, among which we highlight you the minimum percentage of the transaction made by the lender, which may not be covered by a guarantee

Guarantees and identification of the beneficiary



The analysis of the measure must be related to various subjects involved in the operation, in order to identify possible aid beneficiaries

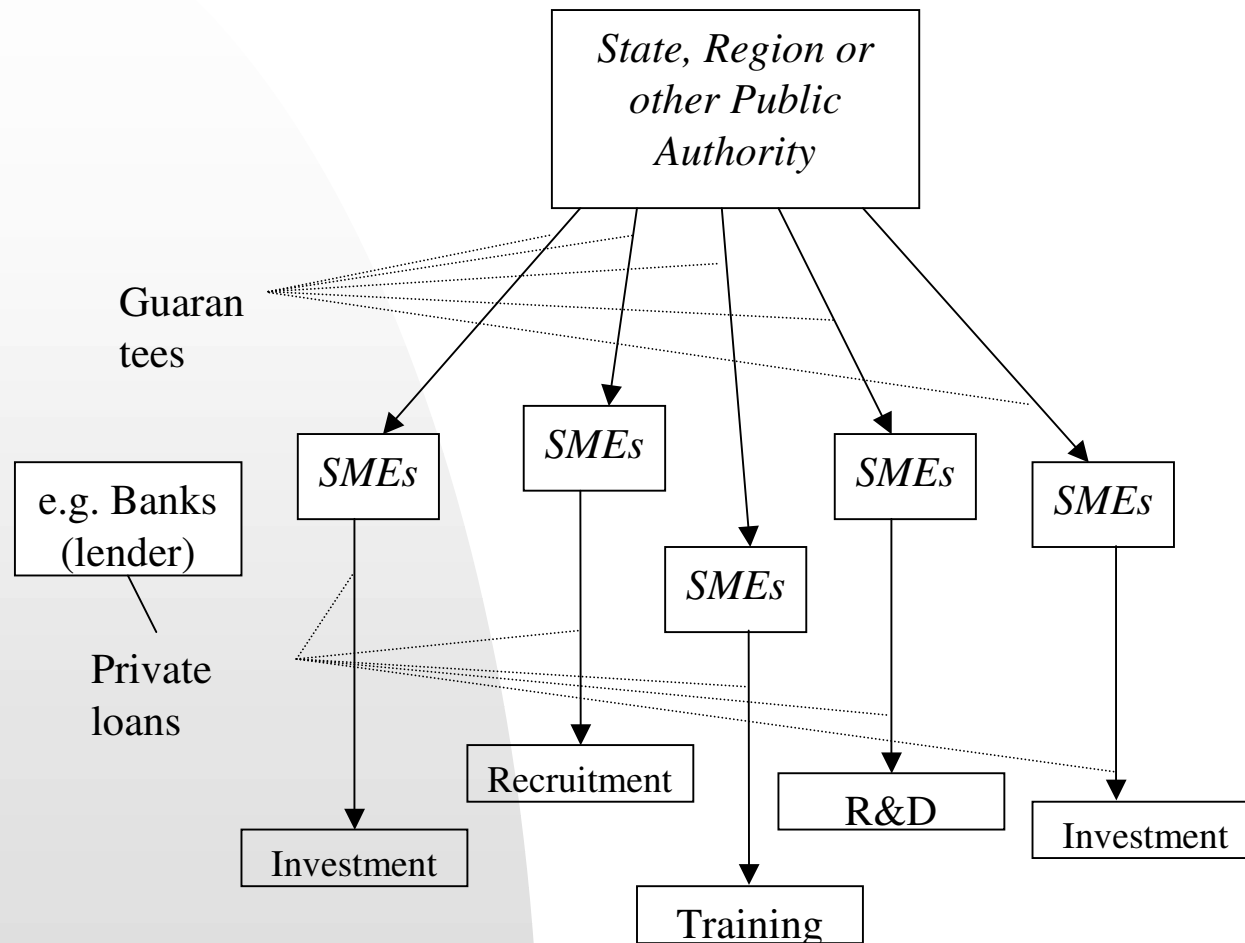
These could be for example, those private subjects which participate to the fund establishment and those fund manager, besides the undertakings beneficiaries of the guarantees

E.g., the Austria's scheme entitled NÖ Bürgschaften GmbH (NOEBEG), requires a holding by the Chambers of Commerce of certain banks, on the State Fund (a federal entity "Niederösterreich")

The "Country report" (WP1) do not provide sufficient information for a classification of the various credit guarantee organizations, to be carried out according to the classical schemes of the "State aid" field

Analysis of the benefit at various levels

Scheme A: guarantees given by the State directly



The Scheme A is the easiest one and it has been taken into account by the Notice on Guarantees, which highlighted the problem of determining the presence of Aid at a borrower level (SMEs in the scheme) or at a lender level (e.g., banks providing loans).

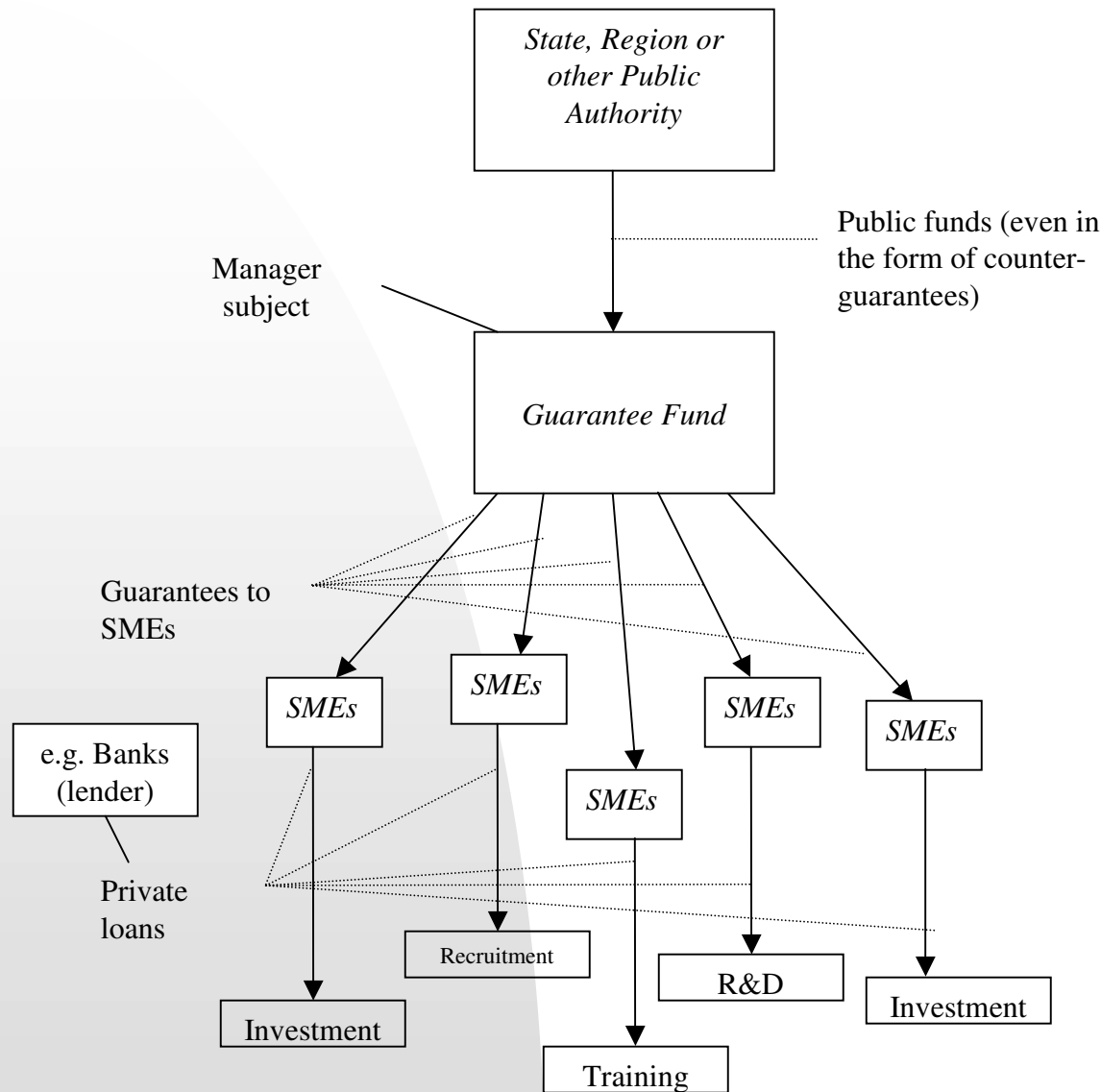
The guarantees containing benefits for the lender

- The Commission in the mentioned Notice, refers to some examples in which there may also be an aid to the lender:
- in so far the security of the loan is increased
- if a State guarantee is given ex post in respect of a loan or other financial obligation already entered into without the terms of this loan or financial obligation being adjusted,
- or if one guaranteed loan is used to pay back another, non-guaranteed loan to the same credit institution.

Every benefit deriving from the State intervention and from the use of public resources, in other terms should be transfer to businesses (SMEs in the scheme)

The guarantees containing benefits for the lender can constitute operating aid, initially forbidden
(See point 5.4 of the Notice on Guarantee).

Scheme B: granting guarantees through a fund



This scheme provides also the possibility to grant an aid to the lender, as illustrated in the example of the Scheme A. However in addition there is the possibility that the State intervention confers benefits to the Fund and/or to the manager of the Fund . The relevant problem of the aid schemes structured as illustrated in the scheme, consists of the exclusion of the presence of aid to the Fund or to the manager of the Fund. Such a aid should be qualified as an operating aid with the mentioned consequences

Guarantees and compatibility according to 'classical' rules on State aid



Once identified the beneficiaries, and where necessary, determined the amount of the grant equivalent, the measure must comply with certain rules of compatibility adopted by the Commission, which are based on the objectives pursued (e.g., R&D, initial investment, employment etc.

... frameworks and guidelines concerning horizontal, regional and sectoral aid", to which, since few years, have been included the exemption regulations

Nevertheless it is useful to shortly indicate a possible approach to the upcoming exemption regulations in a different way. Indeed, the Commission analyzes the problem of calculating the intensity of the aid and the existence of "transparent Aid measures", (that is the measures whose aid value can be easily quantified), as well as "non transparent measures"

*...If the final versions of the future regulations, once adopted should contain these provisions, **the aid granted in the form of guarantees** would not fall within the scope (except for the application of what required by the Article 1 of the draft regulation on the de minimis) of the mentioned regulations and **should not therefore be exempted from notification.***

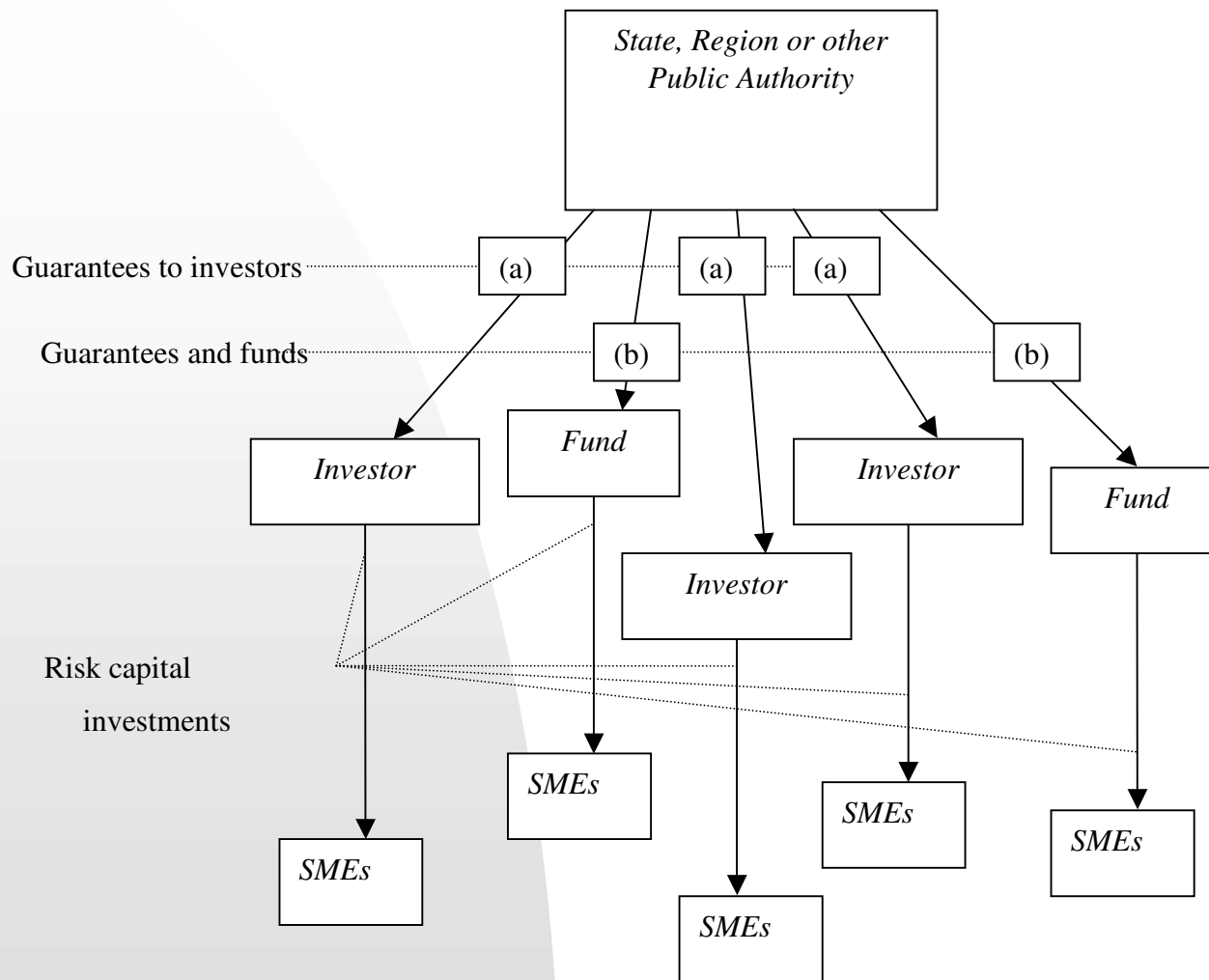
An outline on Guarantees and risk capital

As specified in the *Communication on State aid and risk capital* It should, however, be possible that guarantees "... granted by the State in favour of investments in risk capital are more likely to include an element of aid to the investor than is the case with traditional loan guarantees, which are normally considered to constitute aid to the borrower rather than to the lender "

Various type of use of the "guarantee" tool (The mentioned Communication - OJ No C 235 of 21.08.2001).

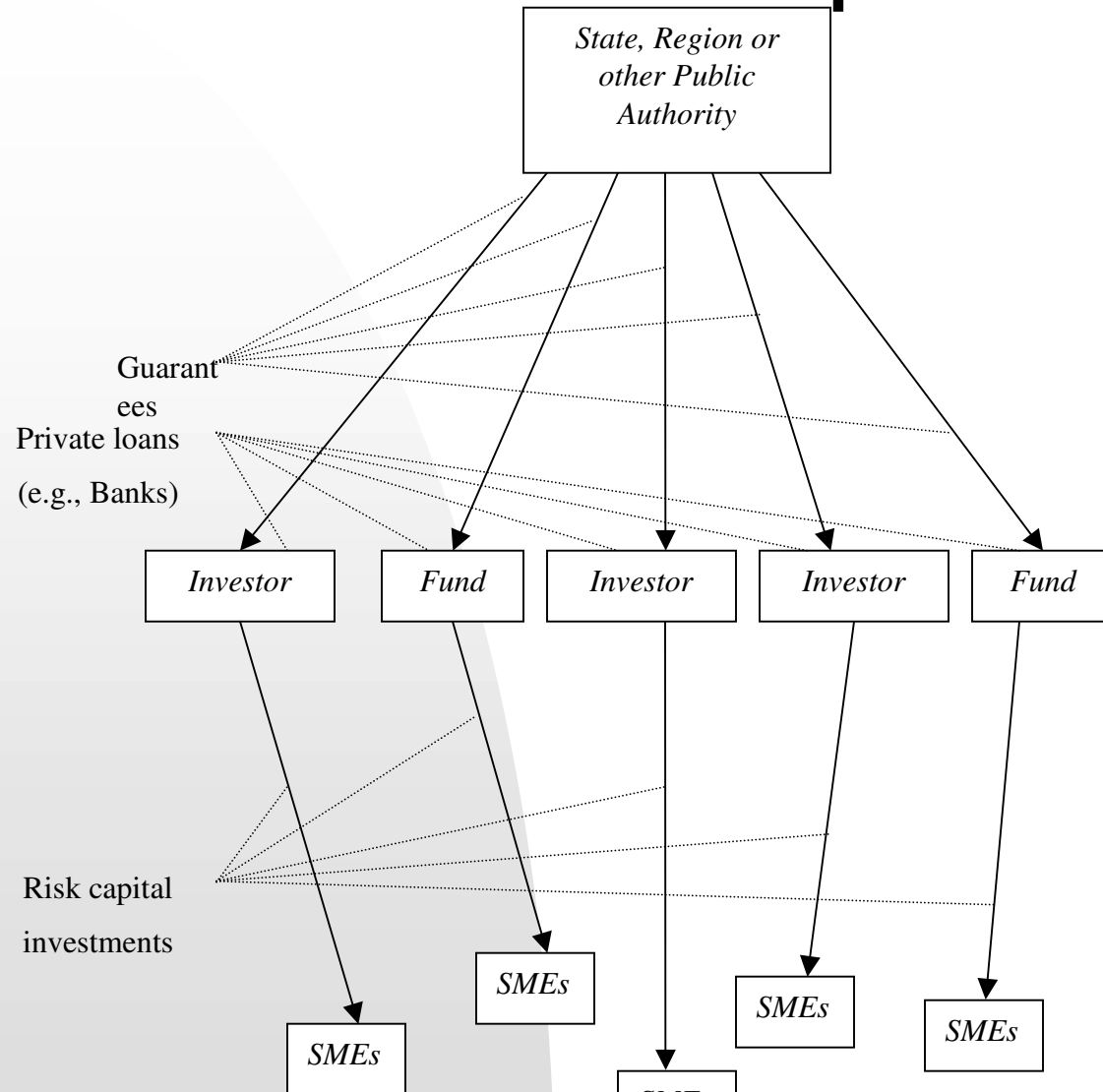
- guarantees given to risk capital investors or to venture capital funds against a proportion of investment losses (scheme C – see the next slides),
- guarantees given in respect of loans to investors/funds for investment in risk capital (scheme D – see the next slides).

Scheme C: guarantees to investors or funds for investment in risk capital



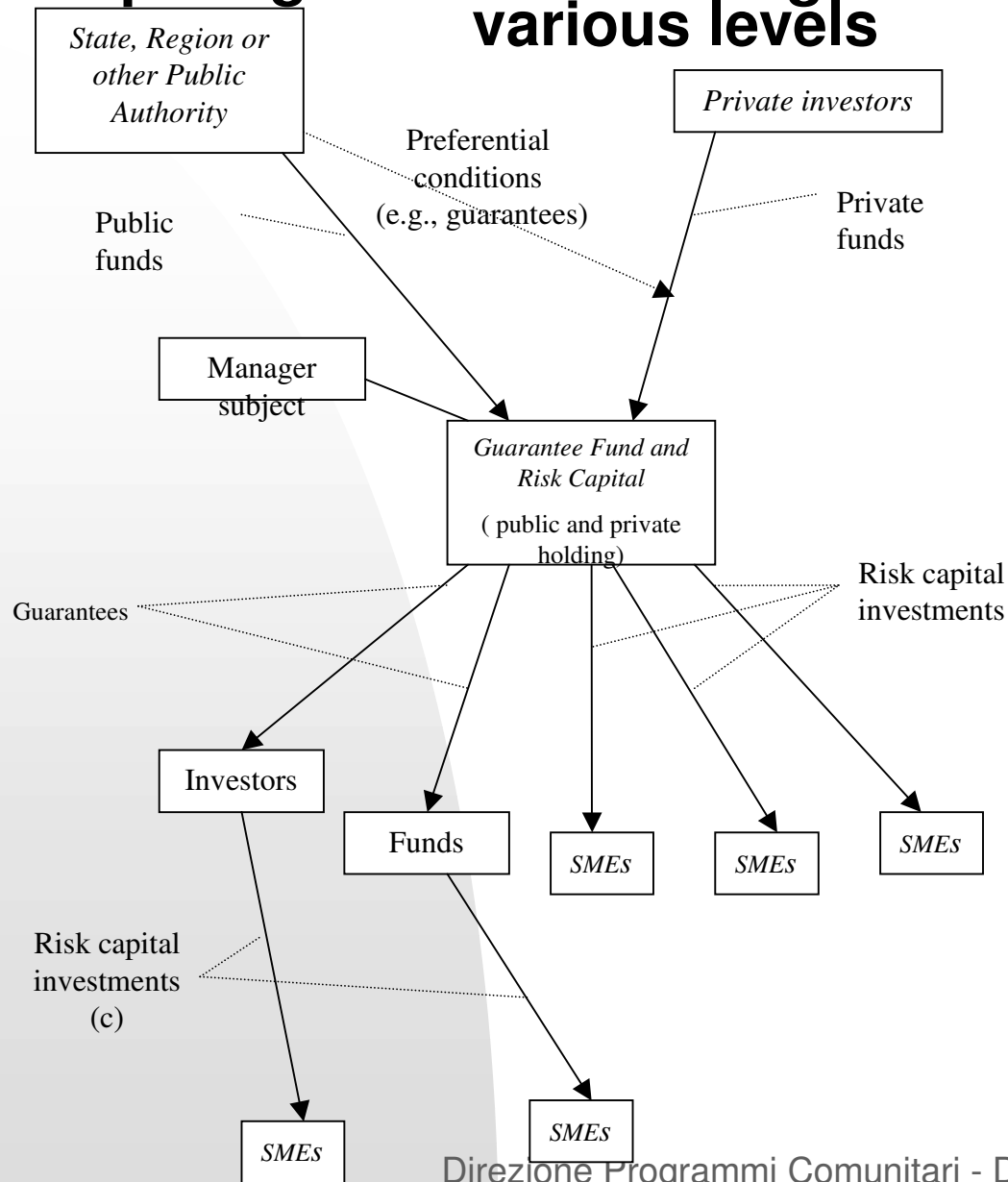
In the *scheme C*, guarantees are given to risk capital investors (a) or to risk capital funds (b) against, for example, a proportion of investment losses effectuated through SMEs beneficiaries of the intervention. As already mentioned, these guarantees should be mainly aimed at encouraging private investors or funds to provide their risk capital to businesses. The guarantee should intervene, because of a market failure, in this case, the benefit or investors, to be considered compatible with the market, must be restricted to the minimum amount required to face the problems related to the market failure.

Scheme D: guarantees given in respect of loans to investors/funds for investment in risk capital



In the *scheme D*, guarantees are aimed at allowing investors or funds to obtain loans for SMEs investments in risk capital. This structure, apparently simple, could therefore imply difficulties related to some specific conditions concerning State Aid and risk capital.

Scheme E: hypothesis of a risk capital measure requiring the use of the "guarantee" tool at various levels



This structure could even be similar to the classical one of the creation of a public and private capital funds, where the State offers preferential conditions to the private, in order to encourage him to participate to the Fund. The fund could support directly risk capital investments in small and medium-sized enterprises (SMEs) or granting guarantees to investors or funds. The investors and the funds, implement risk capital investments in small and medium-sized enterprises (SMEs) (scheme E)