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Subject: State Aid N 35/2009 - Hungary

Method to calculate the aid element in agricultural and fisheries guarantees (to be applied by Garantiqa Hitelgarancia Zrt.)

Madam,

1. PROCEDURE

- (1) By letter dated 23 January 2009, registered at the Commission on the same day, the Hungarian authorities notified pursuant to Article 88(3) of the EC Treaty a methodology to calculate the aid element in state guarantees. Supplementary information was provided by letters of 13 May 2009 and on 27 May 2009.
- (2) On 12 November 2008, the Commission approved a calculation method notified under aid No N 201/a/2007 and entitled "Method to calculate the aid element in guarantees (to be applied by Hitelgarancia Zrt.)" identical to the present calculation method. The approved calculation method covered all guarantees, except for guarantees for agricultural and fisheries proposes. The method to calculate the aid element in agricultural and fisheries guarantees is the subject of the present notification.

2. DESCRIPTION OF THE METHOD

2.1. Objective

- (3) Methodology to calculate the aid element in agricultural guarantees.

2.2. Duration

- (4) From the approval by the Commission to 31.12.2013.

• excellenciája Dr BALÁZS Péter
Külügyminiszter
Bem rakpart 47
H - 1027 BUDAPEST

2.3. Scope of the method

- (5) The Hungarian authorities notified a methodology to calculate the aid element in state guarantees (hereinafter: "calculation method" or "method") as indicated in Recital 14 of Commission Regulation (EC) No 1857/2006 of 15 December 2006 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises active in the production of agricultural products, and amending Regulation (EC) No 70/2001 (hereinafter: Regulation 1857/2006)¹, in Recital 21 and in Article 5(1) (c) (i) of Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (hereinafter: General block exemption Regulation)² and in Recital 18 and in Article 5(1) (c) (i) of Commission Regulation (EC) No 736/2008 of 22 July 2008 on the application of Articles 87 and 88 of the Treaty to State aid to small and medium-sized enterprises active in the production, processing and marketing of fisheries products (hereinafter: Regulation No 736/2008)³.
- (6) After acceptance of the methodology to calculate the gross grant equivalent by the Commission, aid schemes involving state guarantees can be considered as transparent in the sense of the above mentioned Commission Regulations, if the aid element of the state guarantee is calculated on the basis of the approved calculation method.
- (7) The Hungarian authorities intend to use the calculation method also for guarantees provided under the rules on *de minimis* aid. Commission Regulation (EC) No 1535/2007 of 21 December 2007 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid in the sector of agricultural production⁴ (hereinafter: "agricultural *de minimis* regulation") and Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid⁵ (hereinafter: "general *de minimis* regulation") allow Member States to apply a methodology to establish whether the aid content of a guarantee is within the applicable *de minimis* ceiling if this methodology was accepted by the Commission following notification of such a methodology on the basis of, for example, Regulation 1857/2006 and if the approved methodology explicitly addresses the type of guarantees and the type of underlying transactions at stake in the context of the application of the given *de minimis* regulation.

¹ OJ L 358, 16.12.2006, p. 3.

² OJ L 214, 9.8.2008, p. 3.

³ OJ L 201, 30.7.2008, p. 16.

⁴ OJ L 337, 21.12.2007, p. 35.

⁵ OJ L 379, 28.12.2006, p.5

2.4. The guarantee institution

- (8) The method is to be applied by the Garantiqa Hitelgarancia Zrt. (Garantiqa Creditguarantee Co. Ltd., hereinafter: "HG Zrt."), called Hitelgarancia Zrt until 11 April 2008. HG Zrt. was established by the Hungarian state and Hungarian commercial banks in order to support the access of small and medium-sized enterprises to loans and bank guarantees by means of granting them unconditional payment guarantees. The company's service enables State and bank funding to be combined in the financing of SME projects together with the own resources of the borrowing enterprises, and for the risks to be shared among them in a rational manner.
- (9) Of the various owners, the Government of the Republic of Hungary has an ownership share of 50.02 % in the company and, based on this, 50 % + 1 of the votes. The Hungarian Development Bank (MFB Zrt.), a fully State owned entity possesses an additional 13.97 % ownership share. The other owners are major commercial banks, savings co-operatives, business associations and various interest groups.
- (10) HG Zrt. began its operations on 7 December 1992. The volume of its portfolio as at year-end 2007 was HUF 315 billion, of which the agricultural and fisheries portfolio represented HUF 11 billion. (with 631 valid contracts). The guarantees provided by the company for the banks loans and bank guarantees of SMEs were from the outset backed by counter-guarantees of the State.

2.5. The underlying transaction

- (11) The method will be applied to first-demand guarantees provided for investment and working capital loans as well as for financial leasing for the procurement of production assets.

2.6. Beneficiaries

- (12) In application of the method, the beneficiaries of the guarantee can only be undertakings qualifying as small or medium-sized enterprises within the meaning of Annex I to the General block exemption Regulation.
- (13) The method is not applicable to firms in difficulty, the definition of which is in conformity with paragraphs 10 and 11 of Community guidelines on State aid for rescuing and restructuring firms in difficulty⁶.
- (14) The notification at hand covers the application of the method to guarantees for agricultural production, processing and marketing and for the production, processing and marketing of fisheries products.

2.7. Percentage cover of the underlying transaction

- (15) The maximum extent of the guarantee to be issued by HG Zrt. in application of the method may not exceed 80 % of the underlying financial obligation.

⁶ OJ C 244, 1.10.2004, p. 2.

2.8. Maximum amount of the guarantee

- (16) The maximum of the guaranteed amounts in the agricultural and fisheries sector is regulated by the relevant Community legislations: Regulation EC 1857/2006, Regulation No 736/2008, the General block exemption Regulation, the agricultural *de minimis* regulation, the general *de minimis* regulation, Council Regulation EC (No) 1698/2005⁷, Community guidelines for State aid in the agriculture and forestry sector 2007 to 2013 (2006/C 319/01)⁸, Guidelines for the examination of State aid to fisheries and aquaculture (2008/C 84/06)⁹ and Guidelines on national regional aid for 2007-2013 (2006/C 54/08)¹⁰. However, under the method the maximum amount of guarantee that can be undertaken in respect of a single debtor should not exceed the HUF equivalent of EUR 2.5 million.

2.9. Maturity

- (17) Guarantees with a maturity of up to 25 years are covered by the notified method.

2.10. Mobilisation of the guarantee

- (18) The financial institution is eligible for drawing down the guarantee if:
- it has, in accordance with the provisions of the Civil Code and the stipulations of the contract, duly terminated the credit contract or the financial lease contract, or
 - in the case of a failure to pay the final instalment specified in the credit contract or the financial lease contract, it has called upon the obliged party to perform, or
 - winding up proceedings have been launched against the debtor, and
 - based on the financial lease contract it has attempted to repossess the asset and it has
 - sold the repossessed asset, or
 - failed to sell the repossessed asset within 60 days from the date of repossession, or
 - made two unsuccessful attempts at repossession, then filed charges with the police, or
 - in the case of the occurrence of an insured event, and based on the insurance policy taken out in respect of the leased object, settled its claim vis-à-vis the insurance company.

⁷ OJ L 277, 21.10.2005

⁸ OJ C 319, 27.12.2006

⁹ OJ C 84, 3.4.2008

¹⁰ OJ C 54 of 4.3.2006

2.11. The logic of the method

- (19) The method rests on establishing a hypothetical market premium that a private investor would charge. The grant equivalent is the aggregated amount of the yearly differences between this market premium and the actually paid premium that are discounted to the date of granting the guarantee. The methodology calculates the hypothetical market premium individually for each segment identified.
- (20) The core of the calculation consists in establishing, based on own historical data of the institution, what the average annual revenue from guarantee premiums would have had to be over the last 10 years¹¹ so that this revenue covers:
- the 10-year (or at least 3-year) average annual loss (i.e. mobilised guarantee minus recovery) in the given segment;
 - the part of 10-year average annual operating expenses¹² of the guarantee institution falling on the segment (i.e. proportionate to the size of the segment); and
 - a risk premium equal to 0.32 % of the 10-year (or at least 3-year) average outstanding guarantee amount in the given segment.
- (21) The calculated average annual revenue from the premium is divided by the average size of the segment¹³ to obtain the market premium in percentage terms applicable for the segment.

2.12. Segmentation

- (22) The purpose of segmentation is to set up groups of transactions that can be considered homogeneous and also to separate short term (mostly shorter than 12 months) working capital loans from investment and asset leasing loan guarantees.
- (23) There are a total of 3 segments subject to the method under assessment (Széchenyi Card transactions in Segment 1 do not involve agricultural or fisheries guarantees, while loans above HUF 100 million with a guarantee exceeding HUF 500 million in Segment 5 do not include a State counter-guarantee). The segmentation of HG Zrt. is based partly on the characteristics of the risk assessment and the arrangements with the financial institutions, and partly on the amount of the guarantee.

¹¹ Or at least 3 years if historical data are not available for 10 years in the given segment.

¹² Operating expenses are defined as the sum of the following lines in the profit & loss statement: general administrative expenses, depreciation write-offs and other expenditures from business operations.

¹³ The size of the segment is the average end-of-the year amount of guarantees in the given segment. Averaging takes place over a 10-year period, or at least 3 years if even the oldest individual transaction included in the segment took place less than 10 years ago.

- (24) The following segments include agricultural or fisheries guarantees counter-guaranteed by the State:
1. Segment 2: guarantees undertaken based on agreements concluded with banks ("packages")
 2. Segment 3: guarantees for loans and leasing transactions of up to HUF 100 million.
 3. Segment 4: guarantees for loans and leasing transactions exceeding HUF 100 million but where the guarantee amount does not exceed HUF 500 million.
- (25) Bank agreement transactions (packages) in Segment 2 are homogeneous and characterised by a special way of risk management as HG Zrt. does not conduct an individual risk assessment of these smaller transactions but instead relies on the banks' evaluation after concluding agreements with financial institutions whose risk management (debtor assessment, collateral assessment etc.) HG Zrt. considers satisfactory. The average loan amount in the case of agreement with banks is HUF 50 million, while the upper limit is a guarantee amount of HUF 100 million.
- (26) As to the segments 3 and 4, it is only in the case of the guarantee amount that a sufficiently close correlation with defaults could be established. The cut-off point of HUF 100 million is explained by the fact that HG Zrt. charges risk-dependent floating fees for guarantees exceeding this threshold.

2.13. *De minimis* application

- (27) The Hungarian authorities wish to apply the methodology also for calculating the gross grant equivalent of support granted under the agricultural and general *de minimis* regulations. Under the *de minimis* regulations, guarantee support covering working capital loans is also eligible.
- (28) However, guarantees not related to initial investments may have different characteristics from investment loan or leasing guarantees, e.g. in terms of a lower recovery rate due to a more likely lack of collateral.
- (29) Therefore, the Hungarian authorities split historical data on defaults (i.e. mobilised guarantees) and recoveries in the segments concerned (segments 2, 3 and 4) according to the guarantee type (investment loan/leasing or working capital loan). This allows the calculation of the market premium separately for guarantees covering investment loan/leasing and guarantees covering working capital loans.

2.14. The calculated market premiums

- (30) The application of the method (based on historic data from the period between 1998 and 2007) resulted in the following market premiums per segment:

Table 3: Market premium per segments

2/a. segment (working capital guarantees)	4.6%
2/b. segment ((investment guarantees)	1.5%
3/a. segment (working capital guarantees)	2.4%
3/b. segment (investment guarantees)	2.9%
4/a. segment (working capital guarantees)	3.4%
4/b. segment ((investment guarantees)	3.9%

- (31) The market premiums are recalculated on 1 July every year taking into account the latest historic data.
- (32) The gross grant equivalent of guarantees is defined for each year as the difference between the calculated market premium related to the segment and the premium actually charged. In case of guarantees with a longer than 1 year maturity the difference between the discounted values of the premiums is regarded as the gross grant equivalent. The yearly cash grant equivalents are discounted to their present value using the reference rate.

2.15. Reporting

- (33) The Hungarian authorities have committed themselves to submit a yearly report to the Commission on the application of the calculation method. In addition, the Hungarian authorities will keep detailed statistics that allow evaluating the calculation method and the applied values in each category.

3. ASSESSMENT

- (34) The notification concerns a method to be used by HG Zrt. to establish the aid element in guarantees. Therefore, the assessment of this method is without prejudice to any Commission position on the overall relation between the State and HG Zrt.
- (35) Following Recital 21 of the General block exemption Regulation and Recital 18 of the Commission Regulation (EC) No 736/2008 the assessment of the calculation method by the Commission will be carried out according to the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees¹⁴ (hereinafter: "guarantee notice"). Recital 14 of Regulation 1857/2006 refers to the previous guarantee notice¹⁵, which was replaced by the currently applicable guarantee notice on 20 June 2008.

¹⁴ OJ C 155, 20.06.2008, p. 10.

¹⁵ Notice on the application of Article 87 and 88 of the EC treaty to State aid in the Forms of Guarantees , OJ C 71, 11.3.2000, p. 14.

- (36) Point 4.1 of the guarantee notice indicates that:
- (i) As a matter of principle, the State aid element will be deemed to be the difference between the appropriate market price of the guarantee provided individually or through a scheme and the actual price paid for that measure.
 - (ii) The resulting yearly cash grant equivalents should be discounted to their present value using the reference rate, then added up to obtain the total grant equivalent.
 - (iii) When calculating the aid element in a guarantee, the Commission will devote special attention to the following elements:
 - whether in case of guarantee schemes, the eligibility criteria of the scheme provide for exclusion of undertakings in financial difficulty;
 - whether the extent of each guarantee can be properly measured when it is granted;
 - whether the guarantee covers more than 80% of each outstanding loan or other financial obligation;
 - whether the specific characteristics of the guarantee and loan (or other financial obligation) have been taken into account when determining the market premium of the guarantee, from which the aid element is calculated by comparing it with the premium actually paid.
- (37) According to point 4.4 of the guarantee notice the cash grant equivalent of each guarantee within the scheme is the difference between the premium effectively charged (if any) and the premium that should be charged in an equivalent non-aid scheme. The aforementioned theoretical premiums from which the aid element is calculated have therefore to cover the normal risks associated with the guarantee as well as the administrative and capital costs. This way of calculating the grant equivalent is aimed at ensuring that, also over the medium and long term, the total aid granted under the scheme is equal to the money injected by the public authorities to cover the deficit of the scheme. Since, in the case of State guarantee schemes, the specific features of the individual cases may not be known at the time when the scheme is to be assessed, the aid element must be assessed by reference to the provisions of the scheme.
- (38) Point 4.5 of the guarantee notice provides for two simplification tools relating to guarantee schemes for SMEs that can be used for aid calculation purposes: the use of safe-harbour premiums and the use of single premiums.
- (39) The relevant conditions listed in point 4.1 of the guarantee notice are fulfilled, in particular the yearly grant equivalents are discounted to their present value using the reference rate (cf. paragraph (32) *supra*), enterprises in financial difficulty are excluded (cf. paragraph (13) *supra*), the maximum amount of the guarantee is closely monitored (cf. paragraph (16) *supra*), the guarantee only

covers a maximum of 80 % of the underlying transaction (cf. paragraph (15) *supra*) and the specific characteristics of the guarantees have been taken into account when determining the market premium of the guarantee (cf. paragraphs (19)-(29) *supra*). Furthermore, the Hungarian authorities have assured the Commission of the presentation of the reports as requested in point 6 of the guarantee notice (cf. paragraph (33) *supra*).

- (40) The Hungarian method appears to be consistent with point 4.4 of the guarantee notice, since it is based on a theoretical premium that should be charged in an equivalent non-aid scheme. It takes into account historical default and recovery data as well as operating expenses and ensures a remuneration of the capital which is defined in accordance with point 3.4 (f) of the guarantee notice. The resulting market premiums are reasonably high, also when compared in general to the level of safe-harbour premiums provided in the guarantee notice for SMEs.
- (41) The logic of the method ensures that if the calculated market premiums had been charged, the whole scheme (as well as each individual segment) would be self-financing and would even ensure the required risk premium for the adequate capital.
- (42) It is also to be assessed positively that the method is transparent and easily verifiable, relies on own historical data of the institution, and is based on data covering a relatively long (10-year) period.
- (43) However, it should also be noted that the method does not have a clear risk-based segmentation which means that, even though the calculation method is robust and on average the market premium for a given segment is correct, it can hide important differences for the individual guarantees by underestimating the market premium for the riskiest and overestimating it in the case of less risky enterprises in the segment.
- (44) Nevertheless, not carrying out a risk-based segmentation appears to be justified in view of the specific characteristics of the method. For small amounts of guarantee granted to SMEs, it may indeed not be cost-efficient to carry out an individual risk assessment of each beneficiary.
- (45) In addition, point 4.5. of the guarantee notice allows for the use of a single premium in guarantee schemes for SMEs, where the guaranteed amount does not exceed a threshold of EUR 2.5 million per company in a given scheme, by way of derogation from the need to carry out a valuation for each individual guarantee or risk class within the scheme. The notified methodology goes beyond the use of a single premium, as it calculates the hypothetical market premium individually for each identified (though not risk-based) segment, while the maximum guaranteed amount is capped at the EUR 2.5 million threshold per company.
- (46) The present methodology follows the principles of calculating the aid element of a guarantee scheme described in point 4.4 of the guarantee notice without having recourse to the simplified evaluation system based on safe-harbour premiums.

- (47) The methodology also addresses the characteristics of *de minimis* guarantees, which are likely to involve to a large extent guarantees for working capital loans, by using separate datasets and calculating the market premium separately for investment/leasing guarantees and guarantees for working capital loans.

Conclusion

- (48) The Commission concludes that the calculation method allows an appropriate calculation of the risk of the transactions supported by the State and of the aid element in guarantees. The Commission takes the view that the calculation method is in line with the guarantee notice.

4. DECISION

- (49) The Commission therefore accepts that the method is used by the Hungarian authorities for guarantee schemes, as indicated in Regulation 1857/2006, the General block exemption regulation and Regulation 736/2008, to establish the aid element of a loan or leasing guarantee granted by HG Zrt. not later than 31 December 2013. These guarantee schemes can therefore be considered as transparent. Furthermore, the Commission accepts that the method is also used by the Hungarian authorities for guarantee schemes to establish the aid element of a loan or leasing guarantee granted by HG Zrt. under the agricultural and general *de minimis* regulations not later than 31 December 2013.
- (50) If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/community_law/state_aids/index.htm.

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European Commission,
Directorate General for Agriculture and Rural Development
Directorate M: Agricultural legislation
M.2 Competition
Office: Loi 130 5/100
B-1049 Brussels
Fax. (+322) 296 7672

Yours faithfully,
For the Commission

Mariann FISCHER BOEL