Prolongation of the State aid temporary framework

by Mercedes Campo (1)

1. Introduction – The State aid temporary framework

The Commission adopted the State aid temporary framework in December 2008 as a response to the global financial crisis. At that time, and in view of the serious risk of a credit crunch, it was decided that extraordinary policy responses were required, including in the real economy, but for a limited period of time only.

The aim of the temporary framework was to remedy the negative effects of the crisis by facilitating firms’ access to finance. The framework provided Member States with additional possibilities of access to State aid for a period of two years, until the end of 2010.

As for the Banking Communications, the legal basis of the temporary framework was Article 107 (3)(b) of the TFEU, which allows the Commission to declare aid “to remedy a serious disturbance in the economy of a Member State” compatible with the common market.

The temporary framework contained two different sets of instruments: new measures and a temporary adaptation of the existing State aid measures.

New aid measures:

These new aid measures – which are set out below - applied to SMEs and large companies in all sectors, provided they were either sound firms or firms which were not in difficulty on 1 July 2008 but had got into difficulty thereafter as a result of the crisis. Firms already in difficulty on 1 July 2008 were excluded because their difficulties were deemed not to be a result of the financial crisis.

- Compatible limited amount of aid (the 500k measure) which allowed the granting of € 500 000 per undertaking through general schemes to cover investments and/or working capital.

- Subsidised guarantees, SMEs were able to receive a reduction of up to 25% of the annual premium to be paid for new guarantees granted in accordance with the temporary framework safe-harbour provisions. For large companies the reduction was limited to 15%. The guarantee could relate to both investment and working capital loans and it may cover up to 90% of the loan. The safe-harbour premiums could be applied during a period of 2 years with reduction, plus 8 additional years without reduction. The maximum loan benefiting from the guarantee was not allowed to exceed the total annual wage bill of the beneficiary for 2008.

- Subsidised loans, reduction of the interest payments to be paid by the end of 2012 and for all types of loans (without any limit on the amount). The subsidised interest rate was calculated on the basis of the Central Bank overnight rate, instead of the one year interbank offered rate (which is the reference contained in the Commission Communication for setting the reference and discount rates).

- Subsidised loans for the production of green products, investment loans for projects involving the early adaptation to future Community product standards - or even going beyond those standards - benefit from a subsidised interest rate calculated on the basis of the above mentioned methodology, plus an additional reduction of 50% for SMEs and 25% for large companies.

The Commission introduced this “green measure” within the TF because it was considered necessary to maintain environmental goals as a priority despite the financial crisis.

Temporary adaptation of existing State aid instruments:

- Risk capital guidelines, the temporary framework temporarily increased the tranche of finance per target SME (from € 1.5 million to € 2.5 million) and reduced the minimum level of private participation (from 50% to 30%).

- Communication on short-term export credit insurance, simplification of the procedural requirements allowing the State to insure short-term export credit demands deemed to be non marketable, including within the Community (escape clause).

The temporary framework stated that the Commission may provide further clarifications on its

(1) The views expressed in this article are entirely personal and do not reflect any official position of the European Commission.
approach to specific issues. Using this possibility, the Commission adopted a range of amendments to the Framework (7).

2. Phasing-out of the State aid temporary framework: the Commission’s assessment of the situation

An appropriate and timely “exit strategy” from the exceptional measures, which was adopted to counter the financial and economic crisis, is a key element for European recovery.

State aid control remains a key EU instrument to facilitate a successful exit from the crisis. This exit process, for the real economy as well as for the financial sector, should lead to viable solutions that do not discriminate between Member States, while at the same time promoting a return to normal functioning of the market.

Delaying the exit from State support would damage the level playing field and European economies at large; yet it would equally be wrong to place financial stability at risk by an overly abrupt disengagement.

Within the context of this global exit strategy the Commission had to decide whether or not it was appropriate, in view of the economic situation, to stop the application of the temporary framework on the planned date – 31 December 2010.

As already mentioned, the purpose of the temporary framework was to unblock bank lending to companies and thereby ensure their continued access to finance. Consequently, when the financial situation normalises, the temporary framework should normally lapse, giving priority to normal State aid rules.

In order to decide on the expiry/prolongation of the temporary framework, a range of factors were taken into account: the use made of the temporary framework by Member States, the capacity of the financial institutions to supply adequate credit to the creditworthy corporate sector, the effectiveness of the Framework to remedy that problem without leading to distortions that would run counter to the single market and its capacity to contribute to a sustainable recovery beyond 2010, in line with the overall exit strategy designed to support European growth.

2.1. Evaluation of the use made of the State aid temporary framework

The Commission collected information about measures taken by Member States under the temporary framework as well as the state of credit supply to creditworthy companies (6).

The temporary framework has generally been very well received by the Member States and stakeholders. Between 17 December 2008 and 1 October 2010, the Commission approved 73 schemes (8) and 4 ad hoc aid measures on very short deadlines. The majority of these are schemes for aid of up to € 500 000 per company (23 Member States), subsidised guarantee measures (14 Member States) and subsidised loan interest (7 Member States). Moreover, 12 Member States facilitated export activities via export credit schemes.

In 2009 the Commission approved measures totalling approximately € 81.3 billion (9). However, the aggregated aid element of the measures implemented by Member States in 2009 is estimated at € 2.2 billion (6). It appears that Member States were cautious when determining the budget, given the uncertainties as to the depth and duration of the crisis, but they were strict when it came to granting aid, also in view of the budgetary constraints.

In general, the temporary framework was implemented by adopting separate aid schemes for each aid instrument. All of the approved temporary framework schemes were open to all sectors. This horizontal approach is justified by the need to support the economy as a whole.

The significant use of the framework shows that the Commission has provided the Member States with a useful tool to confront the impact of the crisis.

(6) DG Competition carried out an initial evaluation of the temporary framework in October 2009 through a questionnaire sent to the Member States and published in DG Competition’s webpage, with a view to obtaining comments from third parties. At that time, Member States considered the temporary framework as a useful tool which has provided an important support for companies and confirmed that companies were still facing difficulties on access to finance. On 17 March 2010 a second questionnaire was launched focusing on the impact and effectiveness of the temporary framework in the reactivation of access to finance. In addition, a multilateral meeting with the Member States was held on 26 October 2010.

(7) Figure includes only measures that fall under aid to industry and services.

(8) According to the annual reports submitted by Member States and their reply to the Commission’s questionnaire on the Temporary framework.
on the real economy, which serves as an additional instrument to secure credit flows to firms.

2.2. Access to finance

Among other sources, the Commission assessment made use of a range of ECB surveys on access to finance by SMEs and the euro area bank lending survey. These surveys are widely used as a means of analysing issues of access to finance within the euro area and they rely on objective, comparable and continuous data-sets, which are regularly updated.

In general, large companies appeared to be less negatively disposed to the availability of bank financing than SMEs, as the former had partially replaced it with market-based financing.

As regards credit standards, banks that reported a tightening of their credit standards during 2010 were in a slight majority, although the position was far less serious than in 2008 and the first half of 2009, when the vast majority reported a tightening. The industry- or firm-specific outlook, together with expectations as regards general economic activity remained the most important factors contributing to a net tightening of credit standards. Tighter standards were expected in order to meet an increasing demand for funding by enterprises, in particular by SMEs.

While recovery is still fragile and uneven across the Union, some Member States are nevertheless posting modest or even more robust growth rates. In addition, despite some pockets of vulnerability, the health of the banking sector has improved in broad terms compared with the situation one year ago. Lending to the private sector appears to have turned positive in line with past patterns. As the economic recovery establishes itself on firmer ground, and concerns about fiscal sustainability are addressed, conditions on the financial market should continue to improve gradually and provide support to the recovery. However, the uncertainty about developments in particular market segments and countries still remains.

2.3. The Commission’s assessment

The temporary framework has provided ample possibilities for credit support during the crisis. However, it is necessary to prepare the recovery and scale down the support by reserving it only for those companies that really need it.

Despite encouraging signs of stabilisation in financial markets, the Commission – in view of the outstanding problems around access to finance and of the fragility of the recovery - considered it premature to let the temporary framework expire totally by the end of 2010. On the other hand, given that the market situation was far from being as dramatic as in 2008/2009, a full prolongation was not an option either. All in all, it was agreed that a gradual phasing-out of the Framework was the most appropriate response to the market situation.

This type of approach was also in line with that taken with regard to the crisis rules in the financial sector.

3. The prolonged State aid temporary framework

3.1. Main features

The main principles applied to the phasing-out of the temporary framework were the following:

Maintenance of measures that address the remaining market failures: although the market situation has improved, SMEs still face problems of access to finance (although these difficulties appear to be less pronounced for large companies). Therefore, it seems justified to prolong those temporary framework measures that are aimed at facilitating access to finance by SMEs. In the same vein, as regards access to trade, there are still groups of companies and sectors that are finding it difficult to obtain coverage from a private insurer. Consequently, there was also a strong case for prolonging the procedural simplification on short-term export credit insurance during 2011.

Tightening of conditions; measures that will be prolonged during 2011 will be subject to tighter conditions to reflect a gradual transition to the normal State aid regime. This approach will also help to limit possible distortions of competition. In practical terms, this means the following:

- Some measures will be only applicable to SMEs only * SMEs face particular problems of access to finance compared to large companies.
- Reduction of the allowed guaranteed amount from 90% to 80% * This would align the temporary framework provision with the provision in the Guarantee Notice and increase the incentive for the banks providing the underlying loans to carry out a thorough risk assessment.
- A smaller reduction applied to the annual guarantee premium for SMEs from 25% to 15%.
- A smaller reduction applied for green products for SMEs from 50% to 25% and for large companies from 25% to 15%.
- No working capital loans for large enterprises * working capital loans involve operating aid, which
may be highly distorting if granted to large companies. Instead, long term recovery should be promoted by encouraging investment aid.

**Exclusion of firms in difficulty:** the temporary framework aid measures were granted to firms in difficulty if they fell into difficulties after the cut-off date of 1 July 2008. The reasoning behind this provision was that firms that might fall into difficulty because of the financial crisis should benefit from more favourable treatment than firms that were already in difficulty before the crisis. The distinction has become increasingly difficult to maintain from an economic point of view, as the initial credit crunch grew into a wider and deeper recession, requiring the restructuring of entire sectors of the economy which were often already burdened by excessive debts.

Therefore, firms in difficulty should make use of the appropriate instrument: namely the Rescue and Restructuring Guidelines.

**Encouraging long term recovery in line with the EU 2020 priorities:** those temporary measures that contribute to the EU 2020 objectives should be encouraged, either by prolonging their application under the Framework (as with the subsidised loans for the production of green products) or, where possible, by incorporating them into the respective guidelines based on Article 107(3)(c) of the TFEU (as with some of the temporary venture capital adaptations).

**Elimination of the compatible limited amount of aid (500k measure):** the 500k measure is not targeted at one particular objective because this does not encourage the efficient use of public money. Moreover, it may often include operating aid which can have very distortive effects and which is extremely restricted under the normal State aid rules. Consequently, prolonging it will run counter to the need to plan a gradual phasing-out of the exceptional crisis support measures.

Therefore, the Commission considered that the measure should be terminated by 31 December 2010. Nevertheless, the prolonged temporary framework still allows Member States to process pending applications during 2011, as long as they were introduced before 31 December 2010 on the basis of schemes approved by the Commission.

### 3.1. Content

In December 2010, the Commission decided to prolong the temporary framework until the end of 2011, with a special focus on SMEs and a limited range of measures (see table for details):

- subsidised guarantees and subsidised loans (both under stricter conditions);
- subsidised loans for the production of green products (with a smaller reduction);
- the prolongation of the procedural simplification to activate the "escape clause" for short-term export credit finance remains unchanged, which requires the prolongation of the Communication from the Commission on short-term export-credit insurance (until 2012), which also expires at the end of 2010;
- the 500k measure will not be prolonged, but Member States will still be able to process pending applications submitted before 31 December 2010 on the basis of schemes approved by the Commission;
- the temporary increase of the safe-harbour tranche of finance from €1.5 million to €2.5 million per target SME will be introduced into the Risk Capital Guidelines (the lowering of the minimum level of private participation from 50% to 30% will not be extended).

### 4. Concluding remarks

The temporary framework is not an instrument to tackle the manifold effects of the recession as such. It constitutes a well targeted instrument which seeks to address the need for access to finance. The current market conditions justify a prolongation (although under stricter conditions) of this exceptional measure for one more year.

However, we should bear in mind that the ultimate objective of the exit strategy is to revert as soon as possible (market conditions permitting) to the normal State aid rules which already provide many possibilities of stimulating the economy by supporting, for instance, SMEs, employment, research, innovation or environmental protection, while at the same ensuring a level playing field for firms and Member States in the internal market.
## CHANGES BETWEEN THE ORIGINAL AND THE NEW TEMPORARY FRAMEWORK AS FROM 2011

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<td><strong>Subsidised guarantees on bank loans</strong></td>
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<td>- SMEs: reduction of up to 25% compared with margin grid [estimated market rate] for investment &amp; working capital loans</td>
<td>- SMEs: up to 15% reduction from margin grid for investment &amp; working capital loans</td>
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<td>- Large: up to 15% reduction from margin grid for investment &amp; working capital loans</td>
<td>- Large: 0% reduction; only investment loans, Up to 80% guarantee coverage</td>
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<td>- Up to 90% guarantee coverage</td>
<td>- Firms in difficulty excluded</td>
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<td>- Firms in difficulty as of 1 July 2008 included</td>
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**Subsidised bank loans**

| - SMEs: investment & working capital loans | - SMEs: investment & working capital loans |
| - Large: investment & working capital loans | - Large companies - investment loans only |
| - Firms in difficulty as of 1 July 2008 included | - Firms in difficulty excluded |

**Subsidised loans for Green products**

| - Interest-rate reduction of 50% for SMEs | - Interest-rate reduction of 25% for SMEs |
| - Interest-rate reduction of 25% for large companies | - Interest-rate reduction of 15% for large companies |

**Aid up to €500,000 per company with notification**

Normal €200,000 de minimis (no aid) rule applies

**Export credit insurance**

- No changes in TF
- The short-term export-credit communication is prolonged for two years

**Aid to promote Risk Capital investment**

- Increase in the maximum tranches of finance to €2.5 million from €1.5m per SME over 12 months
- Reduction of the level of private participation from 50% to 30%
- Incorporated into point 4.3.1 of the Risk Capital Guidelines. *(the mid-term Review of the Risk Capital Guidelines explains why this modification is necessary and justified).*
- Revert to normal 50/50 rule.