Subject: State aid SA.37824 (2014/N) – Portugal
Portuguese Development Financial Institution

Dear Sir,

The Commission wishes to inform the Portuguese authorities that having examined the information notified on the matter referred to above, it has decided not to raise objections to the measure for the reasons set out below.

1. PROCEDURE

(1) By letter dated 18 August 2014, registered on the same day, the Portuguese authorities notified, according to Article 108(3) of the Treaty on the Functioning of the European Union1 ("TFEU"), the measure to set up the Instituição Financeira de Desenvolvimento, S.A., the Portuguese Development Financial Institution (the "IFD"), to be assessed on the basis of Article 107(3)(c) TFEU. Since that date, a number of exchanges have taken place by which the Portuguese authorities have provided more information on the IFD and updated their notification.

2. DESCRIPTION OF THE MEASURE

2.1. Objective of the measure

(2) The main objective of the measure is to establish the IFD, a new integrated public financial institution, and to approve the remit of its activities in its First Phase. The

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S. Ex.ª o Ministro dos Negócios Estrangeiros
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remit in the First Phase is only to manage the financial instrument programmes under the European Structural and Investment Funds ("ESIF") allocated to Portugal and their reimbursements, and thereby contribute to mitigating market failures in the access of small and medium-sized enterprises ("SMEs") to finance in Portugal.

(3) The measure takes the form of an initial capital injection into IFD.

(4) The creation of the IFD as a new public entity acting within the proposed remit is deemed by the Portuguese authorities to be the best approach for the Portuguese State to promote greater efficiency and effectiveness in the management of financial instruments for supporting SMEs. It will also help the Portuguese State to have an overall and improved view of the constraints of Portuguese SMEs resulting from the market failures in their access to finance. Last but not least, it will help centralise the knowledge gained from implementing those initiatives and using the ESIF. Therefore, it is expected that the IFD will generate economies of scale resulting from the centralization of information, as well as of the process of negotiation, management, implementation and monitoring of the ESIF programmes.

2.2. Legal basis

(5) The legal base of the measure are:

(a) Council of Ministers' Resolution No. 73/2013, of 19 November 2013, which sets out the incorporation process, model and mission of the IFD; and

(b) Decree Law on the incorporation of the IFD, registered under n.º DL 329/2014 in the Council’s Presidency diploma’s book of registry, on 11 September 2014 ("the Decree Law"); and

(c) By-laws of the IFD which are annexed to the Decree Law.

2.3. Granting authority

(6) The aid granting authority is the Ministério das Finanças.

2.4. The IFD and its duration

(7) According to Article 4 of its by-laws, the IFD’s corporate purpose is that of carrying out transactions with the aim of addressing market failures in the financing of viable SMEs through:

(a) Managing and directing investment funds, other autonomous estates or similar instruments sustained by public funds to support the economy; and

(b) Undertaking credit transactions, including the issuance of guarantees and other commitments.

(8) Although legally a private law public company, the IFD will be a State-owned financial institution, entirely capitalised by the Portuguese State. The Portuguese government, through the Treasury, will be the sole shareholder of the IFD and it is foreseen that the IFD will remain fully owned at all times by the Portuguese State.
The IFD's share capital will be EUR 100 million, totally subscribed and represented by 100 million shares with nominal value of 1 EUR.

The IFD will be a finance institution subject to the Portuguese Banking Law (Regime Geral das Instituições de Crédito e Sociedades Financeiras). By its decision of 11 September 2014, the Bank of Portugal granted a licence for the IFD to operate as a financial institution.

The IFD will be subject to the supervision of the Bank of Portugal, and the regular control of the Inspeção-Geral de Finanças and the Tribunal de Contas. The Parliament will also be regularly informed about the fulfilment of the objectives of the IFD.

According to the Portuguese authorities, the IFD will operate under the sectorial dependence of the Ministry of Economy, in liaison with the member of the government responsible for Regional Development, without prejudice to the functions pertaining to the Ministry of Finance in respect of the performance of the shareholder role for the IFD.

The IFD's corporate bodies are the general meeting, the board of directors, the audit committee and the statutory auditor.

The selection and recruitment procedures of the members of the board of directors of the IFD will be subject to the best practices and the relevant legislation applicable to the financial institutions, specifically Fit and Proper requirements, as well as the legal provisions applicable to the public managers, in particular the provisions set forth in Estatuto do Gestor Público (Public Manager Statute). The members of the board of directors of IFD are subject to legal provisions with respect to the conflicts of interests, and the disclosure of holdings and financial interests.

The IFD will create an advisory board comprised of duly qualified and fully independent representatives of the stakeholders relevant to the IFD's activities and of other members of recognised scientific and technical merit. Members of the advisory board are appointed by the sole shareholder, by its own initiative or upon proposal of the board of directors. The advisory board is responsible for issuing non-binding opinions on matters pertaining to the IFD's corporate purpose and activities.

The IFD must, in all circumstances, observe the principles of competition and full transparency.

The legal base does not determine a concrete duration for the IFD. However, the approval for the IFD's First Phase activities for which the Portuguese authorities seek the Commission's authorisation, is granted until 31 December 2020. In 2019 at the latest, if there is a request of the Portuguese authorities to prolong the authorization of the IFD under the State aid rules, the Commission will reassess the First Phase activities still required from the IFD.

The Portuguese authorities have committed not to implement the measure before the Commission's approval.

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2 For the avoidance of doubt, the IFD will not have a banking licence.
2.5. **Budget**

(19) The total budget of the measure is EUR 100 million, which corresponds to the starting capital of the IFD, fully subscribed and paid in cash by the Portuguese government.

(20) Investments made by the IFD will be done from separate programmes with dedicated budgets, not from the initial capital injection.

2.6. **Activities of the IFD**

(21) According to Article 5 of the by-laws of the IFD, the IFD conducts the management of financial instruments which are destined to support the economy and to stimulate and guide entrepreneurial investment and employment creation, mostly acting as a wholesale player. By implementing its purpose, the IFD will be especially responsible for:

(a) The management of financial instruments with recourse to financing from the ESIF, including those related to the European support framework for 2014-2020, in accordance with the EU regulations and Partnership Agreement;

(b) The management of the reimbursements linked to the different programming periods in the context of European funds, provided such reimbursements have not been allocated to any other legal or contractual purpose up until the date of the publication of the Decree Law;

(c) The management of financial instruments with recourse solely to financing from multilateral financial institutions and national development institutions, in accordance with their corporate purpose.

(d) Additionally, the IFD shall also undertake responsibilities in providing technical support on public funding models, promoting competitiveness and the internationalization of Portuguese companies.

(22) The exact details and parameters of all the planned activities of the IFD in the long run are not defined yet. The Portuguese authorities envisage defining its remit progressively in several phases.

(23) The subject of this decision is only the First Phase of the IFD's activities, consisting of the establishment of the IFD and the definition of part of its remit, i.e. the activities that are already clearly defined by the Portuguese authorities and which relate to the implementation of ESIF in the 2014-2020 period. The approval of the First Phase is necessary to enable the Portuguese authorities to have the institutional structure in place when the implementation of the current ESIF programmes starts.

(24) In the First Phase, the IFD will manage and channel ESIF funds allocated to Portugal for the 2014-2020 financing period. The IFD will act as a beneficiary entity in the context of the European rules for the management of financial instruments under the 2014-2020 framework and acting strictly in accordance with those rules. It will

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3 Regulation (EU) No 1303/2013 of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and
manage holding funds or specialised funds with co-investment from private investors to address market failures related to SMEs’ access to debt, equity and quasi-equity funding.

(25) The Portuguese government will also mandate the IFD to manage the funds resulting from the reimbursements of ESIF programmes, including, but not limited to the current 2014-2020 period.

(26) The IFD will strictly follow the Partnership Agreement\(^4\) between Portugal and the Commission, the relevant operational programmes and the terms defined by the Portuguese managing authorities as regards the activities, funds allocated, duration, scope and terms of the programmes, eligibility criteria for the final beneficiaries, and the eligibility and selection criteria for the participating financial intermediaries.

(27) The Portuguese authorities have committed to strictly adhere to all the rules and guidelines applicable to the use of ESIF, which recall the necessity to comply with State aid rules, including with respect to the management of the reimbursements from ESIF programmes.

(28) The IFD will not take deposits or other repayable funds from the public and will not invest in debt issued or guaranteed by the public sector. The IFD will be strictly prohibited from conducting business with the Portuguese public sector in general, including the Portuguese State, the regions and the municipalities. IFD will not invest in debt issued or guaranteed by the consolidated public sector, including non-financial State-owned enterprises, local and regional authorities and their respective companies, nor lend or provide guarantees to that sector.

(29) The IFD will act as a wholesale entity, always in coordination with and via commercial banks, private investors and other private financial intermediaries. Those banks and other financial intermediaries will act as the IFD's partners in the promotion, distribution, placement and co-financing of the programmes managed by the IFD.

(30) Eventually, in a second phase, the activities of the IFD may be extended, in particular to so-called on-lending activities. It is planned that the additional on-lending activities of the IFD will be funded by multilateral financial institutions and national promotional banks. The exact details of such programmes and partners are still under negotiation and the Portuguese authorities have committed to notify any such extension to the Commission and not to commence any additional activities before they obtain approval from the Commission.

(31) The Portuguese authorities also plan, in a later phase, to integrate the existing and ongoing financial instrument programmes within the IFD. Such integration is expected to bring about further efficiencies and effectiveness. The Portuguese authorities have

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committed to notify to the Commission any such aggregation (and to wait for the Commission's approval), before its implementation.

3. **ASSESSMENT OF THE PRESENCE OF STATE AID**

3.1. **Legality**

(32) By notifying the proposed measure before implementation, the Portuguese authorities have fulfilled their obligation under Article 108(3) TFEU.

3.2. **Presence of State aid under Article 107(1) TFEU**

(33) The Commission has assessed the notified measure in the light of Article 107(1) TFEU. In order for a measure to fall within the scope of Article 107(1) TFEU, four cumulative criteria must be met:

(34) First, the measure must involve the use of State resources. In that regard, the initial funding of EUR 100 million comes from the Portuguese Treasury, and therefore constitutes State resources. With respect to reimbursements from financial instrument programmes, those programmes were initially set up from State resources and the State would have received the reimbursements under those programmes if it had not decided to channel their payment to the IFD. Therefore reimbursements from those programmes also constitute State resources.

(35) Second, the measure must confer an advantage on undertakings. In that context, the Commission has examined whether it is necessary to adopt this decision or whether the IFD could start its operations without an approval of the Commission, seen that its activities in First Phase will be principally to implement financial instrument programmes financed from the ESIF, which have to be compliant with State aid law. In that regard, the Commission considers that there are several factors which necessitate the Commission's approval by this decision:

(a) The Decree Law and the by-laws of the IFD, which constitute the legal base of the measure, define the IFD's corporate objective more broadly than the First Phase activities. The Portuguese authorities themselves intend to define the remit of the activities of the IFD in a progressive manner, leaving many possibilities open at this stage, including intervening on the market to provide financial support to SMEs in Portugal in a manner similar to market operators in the banking sector. Even if the aim underlying the creation of the IFD is to remedy a market failure in the financing of those SMEs, that activity may qualify as economic, thereby conferring on the IFD the status of "undertaking" for State aid purposes. Therefore, it is necessary that the Commission assesses step-by-step the parameters of the IFD's remit.

(b) The measure involves the initial capitalisation by EUR 100 million of the IFD by the Portuguese State, including for the setting up of the IFD, which is not

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5 For example, "undertaking credit transactions" is mentioned among the corporate purposes of the IFD in Article 4(1)(b) of the Decree Law.
made on market terms and does not require a return in line with those which would be required by a market operator.

(c) The IFD will manage programmes financed by ESIF. The exclusive management of ESIF is not considered to involve State aid to the management entity, as that entity is acting on behalf of the State in the implementation of State aid programmes. The mere management of ESIF-funded State aid programmes, including when that service is remunerated (and that remuneration does not involve overcompensation), does not constitute economic activity\(^6\). However, the initial capitalisation of IFD is not explicitly for the budget of the measures that the IFD will implement.

(d) The IFD will manage refunds from Union fund programmes, including from earlier periods than the 2014-2020 period. Such refunds constitute State resources. The Portuguese authorities do not yet know how such reimbursements will be utilized by the IFD. Therefore, the Commission cannot at this stage take a position on whether the utilization and management of those refunds will provide an advantage to the IFD making it a beneficiary of aid, or not, and cannot exclude that there might be State aid involved in that respect.

(36) Based on these arguments, the condition that the measure must confer an advantage to an undertaking is fulfilled, since the IFD may engage in activities that are considered economic, thereby competing with private operators that do not enjoy the same advantages as the IFD, and it receives capital from the State on conditions which it would not obtain in the market.

(37) Third, the advantage must be selective in that it is limited to certain undertakings. In that regard, the measure confers advantage only on the IFD, a newly created finance institution, and not to other financial intermediaries.

(38) Fourth, the measure must be likely to distort competition and affect trade between Member States. Financial services are global markets and by their nature affect trade between Member States. The provision of capital on terms which are more favourable than those available on the market is capable of distorting competition.

(39) In light of the above, the measure confers an advantage to the IFD, as the funding is going to be used for the initial capitalisation of the IFD, not on market terms, and it is not excluded that the IFD will carry out an economic activity in competition that of other market players. Therefore, the Commission considers that the measure constitutes State aid to IFD, within the meaning of Article 107(1) TFEU.

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\(^6\) That approach is in line with point 39 of the Risk Finance Guidelines which sets out under what conditions such entity is not considered to be a beneficiary of State aid: “Where the risk finance measure is managed by an entrusted entity, without that entity co-investing with the Member State [from its own resources], the entrusted entity is considered as a vehicle to channel the financing and not a beneficiary of aid, as long as it is not overcompensated. However, where the entrusted entity provides funding to the measure or co-invests with the Member State in a manner similar to financial intermediaries, the Commission will have to assess whether the entrusted entity receives State aid.” Communication from the Commission, Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014, p. 4.
4. ASSESSMENT OF THE COMPATIBILITY OF THE MEASURE

4.1. Scope and criteria for assessing the compatibility

(40) As mentioned in paragraph (18), the Portuguese authorities seek approval only for First Phase of the IFD. Therefore, this decision only concerns the compatibility of the setting up of the IFD and its activities in First Phase.

(41) The IFD will manage and channel indirectly via other financial intermediaries ESIF funds to target SMEs. Those investments may involve State aid, for the purposes of Article 107(1) TFEU, to final beneficiary undertakings, in particular where the investments are not in line with market conduct or do not comply with the de minimis aid rules. However, the existence and compatibility of investments at that level are outside the scope of this decision. It is planned that where necessary, the Portuguese authorities will notify separately the aid schemes to be managed by the IFD, in line with State aid rules.

(42) Article 107(3)(c) TFEU provides that "aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest" may be considered compatible with the internal market.

(43) It is to be noted that the Portuguese authorities have not defined and finalized yet what concrete financial instrument programmes the IFD will implement, including the criteria on eligible undertakings, financial parameters, etc. Therefore, the Commission is not in a position to verify whether the measure, or a part of the measure, could be considered compatible under any existing communication, guideline, framework, regulation, etc., setting out the rules implementing Article 107(3)(c) TFEU.

(44) In light of the above, the Commission has assessed the measure directly under Article 107(3)(c) TFEU and following the common assessment principles. In particular, it has analysed whether the measure: (i) contributes to a well-defined objective of common interest; (ii) is necessary; appropriate; (iii) has an incentive effect; (iv) is proportionate; and (v) avoids undue negative effects on competition and trade between Member States.

4.2. Contribution to a well-defined objective of common interest

(45) The State aid measure must aim at a well-defined objective of common interest. The objective of the measure is to support SMEs' access to finance.

(46) As recognised by the Risk Finance Guidelines, improving access to finance for SMEs is an objective of common interest underpinning the Europe 2020 Strategy. In light of

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that, the Commission finds that the measure targets a well-defined objective of common interest.

4.3. Necessity

(47) State aid must be targeted towards a situation where it can bring about a material improvement that the market cannot deliver itself by remedying a market failure.

(48) The Portuguese authorities have confirmed that in First Phase, the IFD will only manage programmes under the ESIF funds allocated for the 2014-2020 period and refunds from those programmes, as well as from previous programmes. According to Article 37(2) of the Common Provisions Regulation\(^\text{10}\) governing the ESIF funds, "support of financial instruments shall be based on an ex ante assessment which has established evidence of market failures or suboptimal investment situations (...)." Therefore, the Commission concludes that the financial instruments programmes under ESIF managed by IFD will address market failures.

4.4. Appropriateness

(49) The State aid measure must be an appropriate policy instrument to address the objective of common interest. In that regard, the Commission has assessed whether the creation of the IFD is an adequate response to addressing market failures in the SME financing market.

(50) The Commission notes that the current scope of intervention of the IFD is precisely defined and restricted to the managing and delivery of financial instrument programmes within the scope of the ESIF, and the management of the reimbursements.

(51) The IFD will intervene indirectly, through commercial banks and other private financial intermediaries already present in the market. Those entities will act as the IFD's key partners in the promotion, distribution, placement and co-financing of products developed by the IFD. Therefore, the IFD's programmes will leverage additional private co-financing, which is an appropriate means to channel more funding to the identified common objective, i.e. supporting SMEs' access to finance.

(52) The Commission also notes that the integrated management of financial instruments is indeed likely to bring about efficiencies.

(53) In light of the above, the Commission concludes that the measure is appropriate.

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\(^9\) In particular, the Communication from the Commission, Europe 2020, A strategy for smart, sustainable and inclusive growth, (COM(2010) 2020 final, 3.3.2010) sets out a strategy framework for a fresh approach to industrial policy that should put the Union economy on a dynamic growth path strengthening Union competitiveness. It underlines the importance of improving access to finance for businesses, especially for SMEs.

4.5. Incentive effect

(54) State aid must change the behaviour of the undertaking concerned in such a way that it engages in additional activity which it would not carry out without the aid or would carry out in a restricted or different manner. In this regard, the Commission has examined whether the creation of the IFD provides an incentive effect so as to stimulate market forces' response to the identified market failures.

(55) The Commission notes that public funding channelled by the IFD may be co-invested with private investors on a risk-sharing basis. In that regard, the Commission observes that the IFD's interventions are designed to influence the risk-perception of private finance providers, by providing a comfort to the potential investors with respect to the level of riskiness of the target SMEs. Therefore, the intervention by the IFD is also likely to have a signalling effect with respect to SME financing.

(56) Equally, by co-investing with private investors whose interest is to maximise profits, IFD's investments will likely be channelled more towards viable and growing businesses than if it was investing alone.

(57) In light of the above, the Commission concludes that the measure has an incentive effect.

4.6. Proportionality

(58) The State aid measure must be limited to the minimum necessary to induce the additional investments or activity by the undertakings concerned, i.e. whether it would not be possible to reach the same outcome with a lesser amount of aid.

(59) The Portuguese authorities have notified the capitalization of the IFD by EUR 100 million, which they claim is necessary for the setting up of the IFD. The Commission considers that EUR 100 million is indeed proportionate to the creation of a new financial entity, for obtaining the necessary operating licenses and covering the initial costs.

(60) The IFD's interventions will likely leverage financing from private investors, which is an additional mechanism to ensure that the aid to the IFD remains proportionate.

(61) In light of the above, the Commission concludes that the measure is proportionate.

4.7. Avoidance of undue negative effects

(62) The measure implies no or very limited risk of crowding out for a number of reasons.

(63) First, the IFD will intervene indirectly, through private commercial banks and other financial intermediaries. The Portuguese authorities have undertaken to follow all the rules related to the selection of financial intermediaries applicable to the ESIF, and implement the necessary procedures and mechanisms to ensure transparent and unbiased criteria in the selection of the third parties distributing and managing the IFD's financial products and programmes. Accordingly, market operators will be able to participate in the selection process in a non-discriminatory manner.

(64) Second, the IFD will likely leverage additional private investment, typically from the financial intermediaries through which it invests or other private investors. The model
of intervention of IFD as a wholesale entity encourages the crowding-in, rather than the crowding out of private finance providers, since private finance providers that otherwise would be reluctant to provide the financing on their own due to the perceived risks, will be more likely to co-invest with a public finance provider where the risks are shared between them.

(65) In light of the above, the Commission concludes that the negative effects of the measure are limited and the creation of the IFD will not lead to undue distortions of competition.

4.8. Balancing and decision

(66) Having assessed these positive and negative effects of the aid, the Commission considers that the positive effects prevail.

5. Conclusion

(67) The Commission concludes that the notified measure constitutes State aid within the meaning of Article 107(1) TFEU, the aid benefits the IFD itself, and that the measure fulfils the conditions of Article 107(3)(c) TFEU and is therefore compatible with the internal market.

(68) The compatibility of the aid measure to the IFD by the present decision is limited to the notified amount of EUR 100 million. Any further capital injection exceeding that limit requires a formal notification and approval by the Commission.

(69) The activities of the IFD are limited to the management, participation, and channelling of funds under ESIF financial instrument programmes for the 2014-2020 period, and the management of the reimbursements from those programmes, including from previous programming periods. Funding from ESIF may be State aid and therefore those financial instrument programmes need to be compliant with State aid law in circumstances in which the conditions of Article 107(1) TFEU are fulfilled. Refunds from State aid programmes also constitute State resources and therefore need to be compliant with State aid law in circumstances in which the conditions of Article 107(1) TFEU are fulfilled. Any additional activities beyond that remit require formal notification and approval by the Commission.

(70) The Commission reminds the Portuguese authorities that the Commission's approval by this decision is granted until 31 December 2020. Any extension beyond that period requires formal notification and approval by the Commission.
6. **DECISION**

(71) On the basis of the foregoing assessment, the Commission concludes that the proposed measure providing an initial capital injection of EUR 100 million for the setting up of the IFD is compatible with the internal market on the basis of Article 107(3)(c) TFEU.

(72) The Commission reminds the Portuguese authorities that all plans to modify the measure, including but not limited to further funding or modifications to the remit and duration of the IFD, must be notified to the Commission, in compliance with Article 108(3) TFEU.

(73) This approval does not extend to any potential aid to undertakings and/or co-investors resulting from the IFD's interventions.

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/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

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State Aid Registry
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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President