Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees

(2008/C 155/02)

This Notice replaces the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ C 71, 11.3.2000, p. 14).

1. INTRODUCTION

1.1. Background

This Notice updates the Commission's approach to State aid granted in the form of guarantees and aims to give Member States more detailed guidance about the principles on which the Commission intends to base its interpretation of Articles 87 and 88 and their application to State guarantees. These principles are currently laid down in the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees ([1]). Experience gained in the application of this Notice since 2000 suggests that the Commission's policy in this area should be reviewed. In this connection, the Commission wishes to recall for instance its recent practice in various specific decisions ([2]) with respect to the need to undertake an individual assessment of the risk of losses related to each guarantee in the case of schemes. The Commission intends to further make its policy in this area as transparent as possible so that its decisions are predictable and that equal treatment is ensured. In particular, the Commission wishes to provide small and medium-sized enterprises (hereafter 'SMEs') and Member States with safe-harbours predetermining, for a given company and on the basis of its financial rating, the minimum margin that should be charged for a State guarantee in order to be deemed as not constituting aid within the scope of Article 87(1) of the Treaty. Likewise, any shortfall in the premium charged in comparison with that level could be deemed as the aid element.

1.2. Types of guarantee

In their most common form, guarantees are associated with a loan or other financial obligation to be contracted by a borrower with a lender; they may be granted as individual guarantees or within guarantee schemes.

However, various forms of guarantee may exist, depending on their legal basis, the type of transaction covered, their duration, etc. Without the list being exhaustive, the following forms of guarantee can be identified:

— general guarantees, i.e. guarantees provided to undertakings as such as opposed to guarantees linked to a specific transaction, which may be a loan, an equity investment, etc.,

— guarantees provided by a specific instrument as opposed to guarantees linked to the status of the undertaking itself,

— guarantees provided directly or counter guarantees provided to a first level guarantor,

— unlimited guarantees as opposed to guarantees limited in amount and/or time. The Commission also regards as aid in the form of a guarantee the more favourable funding terms obtained by enterprises whose legal form rules out bankruptcy or other insolvency procedures or provides an explicit State guarantee or coverage of losses by the State. The same applies to the acquisition by a State of a holding in an enterprise if unlimited liability is accepted instead of the usual limited liability,

— guarantees clearly originating from a contractual source (such as formal contracts, letters of comfort) or another legal source as opposed to guarantees whose form is less visible (such as side letters, oral commitments), possibly with various levels of comfort that can be provided by this guarantee.

([1]) OJ C 71, 11.3.2000, p. 14.

([2]) For example: Commission Decision 2003/706/EC of 23 April 2003 on the aid scheme implemented by Germany entitled 'Guarantee schemes of the Land of Brandenburg for 1991 and 1994' — State aid C 45/98 (ex NN 45/97) (OJ L 263, 14.10.2003, p. 1); Commission Decision of 16 December 2003 on the guarantee schemes in ship financing — Germany (N 512/03) (OJ C 62, 11.3.2004, p. 3); Commission Decision 2006/599/EC of 6 April 2005 on the aid scheme which Italy is planning to implement for ship financing (OJ L 244, 7.9.2006, p. 17).

Especially in the latter case, the lack of appropriate legal or accounting records often leads to very poor traceability. This is true both for the beneficiary and for the State or public body providing it and, as a result, for the information available to third parties.

1.3. **Structure and scope of the Notice**

For the purpose of this Notice:

(a) 'guarantee scheme' means any tool on the basis of which, without further implementing measures being required, guarantees can be provided to undertakings respecting certain conditions of duration, amount, underlying transaction, type or size of undertakings (such as SMEs);

(b) 'individual guarantee' means any guarantee provided to an undertaking and not awarded on the basis of a guarantee scheme.

Sections 3 and 4 of this Notice are designed to be directly applicable to guarantees linked to a specific financial transaction such as a loan. The Commission considers that, owing to their frequency and the fact that they can usually be quantified, these are the cases where guarantees most need to be classed as constituting State aid or otherwise.

As in most cases the transaction covered by a guarantee would be a loan, the Notice will further refer to the principal beneficiary of the guarantee as the 'borrower' and to the body whose risk is diminished by the State guarantee as the 'lender'. The use of these two specific terms also aims to facilitate understanding of the rationale underpinning the text, since the basic principle of a loan is broadly understood. However, it does not ensue that Sections 3 and 4 are only applicable to a loan guarantee. They apply to all guarantees where a similar transfer of risk takes place such as an investment in the form of equity, provided the relevant risk profile (including the possible lack of collateralisation) is taken into account.

The Notice applies to all economic sectors, including the agriculture, fisheries and transport sectors without prejudice to specific rules relating to guarantees in the sector concerned.

This Notice does not apply to export credit guarantees.

1.4. **Other types of guarantee**

Where certain forms of guarantee (see point 1.2) involve a transfer of risk to the guarantor and where they do not display one or more of the specific features referred to in point 1.3, for instance insurance guarantees, a case-by-case analysis will have to be made for which, as far as is necessary, the applicable Sections or methodologies described in this Notice will be applied.

1.5. **Neutrality**

This Notice applies without prejudice to Article 295 of the Treaty and thus does not prejudice the rules in Member States governing the system of property ownership. The Commission is neutral as regards public and private ownership.

In particular, the mere fact that the ownership of an undertaking is largely in public hands is not sufficient in itself to constitute a State guarantee provided there are no explicit or implicit guarantee elements.

2. **APPLICABILITY OF ARTICLE 87(1)**

2.1. **General remarks**

Article 87(1) of the Treaty states that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

These general criteria equally apply to guarantees. As for other forms of potential aid, guarantees given directly by the State, namely by central, regional or local authorities, as well as guarantees given through State resources by other State-controlled bodies such as undertakings and imputable to public authorities ([3]), may constitute State aid.

In order to avoid any doubts, the notion of State resources should thus be clarified as regards State guarantees. The benefit of a State guarantee is that the risk associated with the guarantee is carried by the State. Such risk-carrying by the State should normally be remunerated by an appropriate premium. Where the State forgoes all or part of such a premium, there is both a benefit for the undertaking and a drain on the resources of the State. Thus, even if it turns out that no payments are ever made by the State under a guarantee, there may nevertheless be State aid under Article 87(1) of the Treaty. The aid is granted at the moment when the guarantee is given, not when the guarantee is invoked nor when payments are made under the terms of the guarantee. Whether or not a guarantee constitutes State aid, and, if so, what the amount of that State aid may be, must be assessed at the moment when the guarantee is given.

In this context the Commission points out that the analysis under State aid rules does not prejudge the compatibility of a given measure with other Treaty provisions.

2.2. **Aid to the borrower**

Usually, the aid beneficiary is the borrower. As indicated under point 2.1, risk-carrying should normally be remunerated by an appropriate premium. When the borrower does not need to pay the premium, or pays a low premium, it obtains an advantage. Compared to a situation without guarantee, the State guarantee enables the borrower to obtain better financial terms for a loan than those normally available on the financial markets. Typically, with the benefit of the State guarantee, the borrower can obtain lower rates and/or offer less security. In some cases, the borrower would not, without a State guarantee, find a financial institution prepared to lend on any terms. State guarantees may thus facilitate the creation of new business and enable certain undertakings to raise money in order to pursue new activities. Likewise, a State guarantee may help a failing firm remain active instead of being eliminated or restructured, thereby possibly creating distortions of competition.

2.3. **Aid to the lender**

2.3.1. Even if usually the aid beneficiary is the borrower, it cannot be ruled out that under certain circumstances the lender, too, will directly benefit from the aid. In particular, for example, 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, then there may also be aid to the lender, in so far as the security of the loans is increased. Where the guarantee contains aid to the lender, attention should be drawn to the fact that such aid might, in principle, constitute operating aid.

2.3.2. Guarantees differ from other State aid measures, such as grants or tax exemptions, in that, in the case of a guarantee, the State also enters into a legal relationship with the lender. Therefore, consideration has to be given to the possible consequences for third parties of State aid that has been illegally granted. In the case of State guarantees for loans, this concerns mainly the lending financial institutions. In the case of guarantees for bonds issued to obtain financing for undertakings, this concerns the financial institutions involved in the issuance of the bonds. The question whether the illegality of the aid affects the legal relations between the State and third parties is a matter which has to be examined under national law. National courts may have to examine whether national law prevents the guarantee contracts from being honoured, and in that assessment the Commission considers that they should take account of the breach of Community law. Accordingly, lenders may have an interest in verifying, as a standard precaution, that the Community rules on State aid have been observed whenever guarantees are granted. The Member State should be able to provide a case number issued by the Commission for an individual case or a scheme and possibly a non-confidential copy of the Commission's decision together with the relevant reference to the *Official Journal of the European Union*. The Commission for its part will do its utmost to make available in a transparent manner information on cases and schemes approved by it.

([3]) See Case C-482/99, *France v Commission* (Stardust) [2002] ECR I-4397.

3. CONDITIONS RULING OUT THE EXISTENCE OF AID

3.1. General considerations

If an individual guarantee or a guarantee scheme entered into by the State does not bring any advantage to an undertaking, it will not constitute State aid.

In this context, in order to determine whether an advantage is being granted through a guarantee or a guarantee scheme, the Court has confirmed in its recent judgments ([4]) that the Commission should base its assessment on the principle of an investor operating in a market economy (hereafter referred to as the 'market economy investor principle'). Account should therefore be taken of the effective possibilities for a beneficiary undertaking to obtain equivalent financial resources by having recourse to the capital market. State aid is not involved where a new funding source is made available on conditions which would be acceptable for a private operator under the normal conditions of a market economy ([5]).

In order to facilitate the assessment of whether the market economy investor principle is fulfilled for a given guarantee measure, the Commission sets out in this Section a number of sufficient conditions for the absence of aid. Individual guarantees are covered in point 3.2 with a simpler option for SMEs in point 3.3. Guarantee schemes are covered in point 3.4 with a simpler option for SMEs in point 3.5.

3.2. Individual guarantees

Regarding an individual State guarantee, the Commission considers that the fulfilment of all the following conditions will be sufficient to rule out the presence of State aid.

(a) The borrower is not in financial difficulty.

In order to decide whether the borrower is to be seen as being in financial difficulty, reference should be made to the definition set out in the Community guidelines on State aid for rescuing and restructuring firms in difficulty ([6]). SMEs which have been incorporated for less than three years shall not be considered as being in difficulty for that period for the purposes of this Notice.

(b) The extent of the guarantee can be properly measured when it is granted. This means that the guarantee must be linked to a specific financial transaction, for a fixed maximum amount and limited in time.

(c) The guarantee does not cover more than 80 % of the outstanding loan or other financial obligation; this limitation does not apply to guarantees covering debt securities ([7]).

The Commission considers that if a financial obligation is wholly covered by a State guarantee, the lender has less incentive to properly assess, secure and minimise the risk arising from the lending operation, and in particular to properly assess the borrower's creditworthiness. Such risk assessment might, due to lack of means, not always be taken over by the State guarantor. This lack of incentive to minimise the risk of non-repayment of the loan might encourage lenders to contract loans with a greater than normal commercial risk and could thus increase the amount of higher-risk guarantees in the State's portfolio.

([4]) See Case C-482/99 referred to in footnote 3.

([5]) See Commission Communication on the application of Article 92 and 93 of the EC Treaty to public shareholdings (Bulletin of the European Communities No 9-1984); Joined Cases 296/82 and 318/82, *Netherlands and Leeuwarder Papierwarenfabriek BV v Commission* [1985] ECR 809, paragraph 17. Commission Communication on the application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector (OJ C 350, 10.12.1994, p. 5), points 25 and 26.

([6]) OJ C 244, 1.10.2004, p. 2.

([7]) For the definition of 'debt securities', see Article 2(1)(b) of Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, p. 38). Directive as last amended by Directive 2008/22/EC (OJ L 76, 19.3.2008, p. 50).

This limitation of 80 % does not apply to a public guarantee granted to finance a company whose activity is solely constituted by a properly entrusted Service of General Economic Interest (SGEI) ([8]) and when this guarantee has been provided by the public authority having put in place this entrustment. The limitation of 80 % applies if the company concerned provides other SGEIs or other economic activities.

In order to ensure that the lender effectively bears part of the risk, due attention must be given to the following two aspects:

— when the size of the loan or of the financial obligation decreases over time, for instance because the loan starts to be reimbursed, the guaranteed amount has to decrease proportionally, in such a way that at each moment in time the guarantee does not cover more than 80 % of the outstanding loan or financial obligation,

— losses have to be sustained proportionally and in the same way by the lender and the guarantor. In the same manner, net recoveries (i.e. revenues excluding costs for claim handling) generated from the recuperation of the debt from the securities given by the borrower have to reduce proportionally the losses borne by the lender and the guarantor. First-loss guarantees, where losses are first attributed to the guarantor and only then to the lender, will be regarded as possibly involving aid.

If a Member State wishes to provide a guarantee above the 80 % threshold and claims that it does not constitute aid, it should duly substantiate the claim, for instance on the basis of the arrangement of the whole transaction, and notify it to the Commission so that the guarantee can be properly assessed with regards to its possible State aid character.

(d) A market-oriented price is paid for the guarantee.

As indicated under point 2.1, risk-carrying should normally be remunerated by an appropriate premium on the guaranteed or counter-guaranteed amount. When the price paid for the guarantee is at least as high as the corresponding guarantee premium benchmark that can be found on the financial markets, the guarantee does not contain aid.

If no corresponding guarantee premium benchmark can be found on the financial markets, the total financial cost of the guaranteed loan, including the interest rate of the loan and the guarantee premium, has to be compared to the market price of a similar non-guaranteed loan.

In both cases, in order to determine the corresponding market price, the characteristics of the guarantee and of the underlying loan should be taken into consideration. This includes: the amount and duration of the transaction; the security given by the borrower and other experience affecting the recovery rate evaluation; the probability of default of the borrower due to its financial position, its sector of activity and prospects; as well as other economic conditions. This analysis should notably allow the borrower to be classified by means of a risk rating. This classification may be provided by an internationally recognised rating agency or, where available, by the internal rating used by the bank providing the underlying loan. The Commission points to the link between rating and default rate made by international financial institutions, whose work is also publicly available ([9]). To assess whether the premium is in line with the market prices the Member State can carry out a comparison of prices paid by similarly rated undertakings on the market.

The Commission will therefore not accept that the guarantee premium is set at a single rate deemed to correspond to an overall industry standard.

([8]) Such an SGEI must comply with Community rules such as Commission Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty 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 312, 29.11.2005, p. 67), and the Community framework for State aid in the form of public service compensation (OJ C 297, 29.11.2005, p. 4).

([9]) Such as Table 1 on agencies' credit ratings to be found in the Bank for International Settlements Working Paper No 207, available at:
http://www.bis.org/publ/work207.pdf

3.3. **Valuation of individual guarantees for SMEs**

As an exception, if the borrower is an SME ([10]), the Commission can by way of derogation from point 3.2(d) accept a simpler evaluation of whether or not a loan guarantee involves aid. In that case, and provided all the other conditions laid down in points 3.2(a), (b) and (c) are met, a State guarantee would be deemed as not constituting aid if the minimum annual premium ('safe-harbour premium' ([11])) set out in the following table is charged on the amount effectively guaranteed by the State, based on the rating of the borrower ([12]):

Credit quality	Standard & Poor's	Fitch	Moody's	Annual safe-harbour premium
Highest quality	AAA	AAA	Aaa	0,4 %
Very strong payment capacity	AA +	AA +	Aa 1	
	AA	AA	Aa 2	0,4 %
	AA –	AA –	Aa 3	
Strong payment capacity	A +	A +	A 1	
	A	A	A 2	0,55 %
	A –	A –	A 3	
Adequate payment capacity	BBB +	BBB +	Baa 1	
	BBB	BBB	Baa 2	0,8 %
	BBB –	BBB –	Baa 3	
Payment capacity is vulnerable to adverse conditions	BB +	BB +	Ba 1	
	BB	BB	Ba 2	2,0 %
	BB –	BB –	Ba 3	
Payment capacity is likely to be impaired by adverse conditions	B +	B +	B 1	3,8 %
	B	B	B 2	
	B –	B –	B 3	6,3 %
Payment capacity is dependent upon sustained favourable conditions	CCC +	CCC +	Caa 1	No safe-harbour annual premium can be provided
	CCC	CCC	Caa 2	
	CCC –	CCC –	Caa 3	
	CC	CC		
		C		
In or near default	SD	DDD	Ca	No safe-harbour annual premium can be provided
	D	DD	C	
		D		

([10]) 'SMEs' refer to small and medium-sized enterprises as defined in Annex I to Regulation (EC) No 70/2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises (OJ L 10, 13.1.2001, p. 33). Regulation as last amended by Regulation (EC) No 1976/2006 (OJ L 368, 23.12.2006, p. 85).

([11]) These safe-harbour premiums are established in line with the margins determined for loans to similarly rated undertakings in the Communication from the Commission on the revision of the method for setting the reference and discount rates (OJ C 14, 19.1.2008, p. 6). Following the study commissioned by the Commission on that topic: (http://ec.europa.eu/comm/competition/state_aid/studies_reports/full_report.pdf, see pages 23 and 156-159 of the study), a general reduction of 20 basis points has been taken into account. This reduction corresponds to the difference in margin for a similar risk between a loan and a guarantee in order to take into account the additional costs specifically linked to loans.

([12]) The table refers to the rating classes of Standard & Poor's, Fitch and Moody's, which are the rating agencies most frequently used by the banking sector in order to link their own rating system, as described in point 3.2(d). However, ratings do not need to be obtained from those specific rating agencies. National rating systems or rating systems used by banks to reflect default rates are equally acceptable provided they supply the one-year probability of default as this figure is used by rating agencies to rank companies. Other systems should allow for a similar classification through this ranking key.

The safe-harbour premiums apply to the amount effectively guaranteed or counter-guaranteed by the State at the beginning of each year concerned. They must be considered as the minimum to be applied with respect to a company whose credit rating is at least equal to those given in the table ([13]).

In the case of a single upfront guarantee premium, the loan guarantee is deemed to be free of aid if it is at least equal to the present value of the future guarantee premiums as indicated above, the discount rate used being the corresponding reference rate ([14]).

As outlined in the table above, companies with a rating corresponding to CCC/Caa or worse cannot benefit from this simplified methodology.

For SMEs which do not have a credit history or a rating based on a balance sheet approach, such as certain special purpose companies or start-up companies, the safe-harbour premium is set at 3,8 % but this can never be lower than the premium which would be applicable to the parent company or companies.

These margins may be revised from time to time to take account of the market situation.

3.4. **Guarantee schemes**

For a State guarantee scheme, the Commission considers that the fulfilment of all the following conditions will rule out the presence of State aid:

(a) the scheme is closed to borrowers in financial difficulty (see details in point 3.2(a));

(b) the extent of the guarantees can be properly measured when they are granted. This means that the guarantees must be linked to specific financial transactions, for a fixed maximum amount and limited in time;

(c) the guarantees do not cover more than 80 % of each outstanding loan or other financial obligation (see details and exceptions in point 3.2(c));

(d) the terms of the scheme are based on a realistic assessment of the risk so that the premiums paid by the beneficiaries make it, in all probability, self-financing. The self-financing nature of the scheme and the proper risk orientation are viewed by the Commission as indications that the guarantee premiums charged under the scheme are in line with market prices.

This entails that the risk of each new guarantee has to be assessed, on the basis of all the relevant factors (quality of the borrower, securities, duration of the guarantee, etc). On the basis of this risk analysis, risk classes ([15]) have to be defined, the guarantee has to be classified in one of these risk classes and the corresponding guarantee premium has to be charged on the guaranteed or counter-guaranteed amount;

(e) in order to have a proper and progressive evaluation of the self-financing aspect of the scheme, the adequacy of the level of the premiums has to be reviewed at least once a year on the basis of the effective loss rate of the scheme over an economically reasonable time horizon, and premiums adjusted accordingly if there is a risk that the scheme may no longer be self-financing. This adjustment may concern all issued and future guarantees or only the latter;

(f) in order to be viewed as being in line with market prices, the premiums charged have to cover the normal risks associated with granting the guarantee, the administrative costs of the scheme, and a yearly remuneration of an adequate capital, even if the latter is not at all or only partially constituted.

As regards administrative costs, these should include at least the specific initial risk assessment as well as the risk monitoring and risk management costs linked to the granting and administration of the guarantee.

([13]) For example, a company to which a bank assigns a credit rating corresponding to BBB-/Baa3 should be charged a yearly guarantee premium of at least 0,8 % on the amount effectively guaranteed by the State at the beginning of each year.

([14]) See the Communication referred to in footnote 11 providing that: '*The reference rate is also to be used as a discount rate, for calculating present values. To that end, in principle, the base rate increased by a fixed margin of 100 basis points will be used*' (p. 4).

([15]) See further details in footnote 12.

As regards the remuneration of the capital, the Commission observes that usual guarantors are subject to capital requirement rules and, in accordance with these rules, are forced to constitute equity in order not to go bankrupt when there are variations in the yearly losses related to the guarantees. State guarantee schemes are normally not subject to these rules and thus do not need to constitute such reserves. In other words, each time the losses stemming from the guarantees exceed the revenues from the guarantee premiums, the deficit is simply covered by the State budget. This State guarantee to the scheme puts the latter in a more favourable situation than a usual guarantor. In order to avoid this disparity and to remunerate the State for the risk it is taking, the Commission considers that the guarantee premiums have to cover the remuneration of an adequate capital.

The Commission considers that this capital has to correspond to 8 % ([16]) of the outstanding guarantees. For guarantees granted to undertakings whose rating is equivalent to AAA/AA- (Aaa/Aa3), the amount of capital to be remunerated can be reduced to 2 % of the outstanding guarantees. Meanwhile, with regard to guarantees granted to undertakings whose rating is equivalent to A+/A- (A1/A3), the amount of capital to be remunerated can be reduced to 4 % of the outstanding guarantees.

The normal remuneration of this capital is made up of a risk premium, possibly increased by the risk-free interest rate.

The risk premium must be paid to the State on the adequate amount of capital in all cases. Based on its practice, the Commission considers that a normal risk premium for equity amounts to at least 400 basis points and that such risk premium should be included in the guarantee premium charged to the beneficiaries ([17]).

If, as in most State guarantee schemes, the capital is not provided to the scheme and therefore there is no cash contribution by the State, the risk-free interest rate does not have to be taken into account. Alternatively, if the underlying capital is effectively provided by the State, the State has to incur borrowing costs and the scheme benefits from this cash by possibly investing it. Therefore the risk-free interest rate has to be paid to the State on the amount provided. Moreover, this charge should be taken from the financial income of the scheme and does not necessarily have to impact the guarantee premiums ([18]). The Commission considers that the yield of the 10-year government bond may be used as a suitable proxy for the risk-free rate taken as normal return on capital;

(g) in order to ensure transparency, the scheme must provide for the terms on which future guarantees will be granted, such as eligible companies in terms of rating and, when applicable, sector and size, maximum amount and duration of the guarantees.

3.5. **Valuation of guarantee schemes for SMEs**

In view of the specific situation of SMEs and in order to facilitate their access to finance, especially through the use of guarantee schemes, two specific possibilities exist for such companies:

— the use of safe-harbour premiums as defined for individual guarantees to SMEs,

— the valuation of guarantee schemes as such by allowing the application of a single premium and avoiding the need for individual ratings of beneficiary SMEs.

([16]) Corresponding to the capital requirements laid down in Article 75 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006, p. 1) read in conjunction with Annex VI (paragraph 41 onwards) thereto.

([17]) For a guarantee to a BBB rated company amounting to 100, the reserves to be constituted thus amount to 8. Applying 400 basis points (or 4 %) to this amount results in annual capital costs of 8 % × 4 % = 0,32 % of the guaranteed amount, which will impact the price of the guarantee accordingly. If the one-year default rate anticipated by the scheme for this company is, for instance, 0,35 % and the yearly administrative costs are estimated at 0,1 %, the price of the guarantee deemed as non-aid will be 0,77 % per year.

([18]) In that case, and provided the risk-free rate is deemed to be 5 %, the annual cost of the reserves to be constituted will be, for the same guarantee of 100 and reserves of 8 to be constituted, 8 % × (4 % + 5 %) = 0,72 % of the guaranteed amount. Under the same assumptions (default rate of 0,35 % and administrative costs of 0,1 %), the price of the guarantee would be 0,77 % per year and an additional charge of 0,4 % should be paid by the scheme to the State.

The conditions of use of both rules are defined as follows:

Use of safe-harbour premiums in guarantee schemes for SMEs

In line with what is proposed for simplification purposes in relation to individual guarantees, guarantee schemes in favour of SMEs can also, in principle, be deemed self-financing and not constitute State aid if the minimum safe-harbour premiums set out in point 3.3 and based on the ratings of undertakings are applied ([19]). The other conditions set out in points 3.4(a), (b) and (c) as well as in point 3.4(g) still have to be fulfilled, and the conditions set out in points 3.4(d), (e) and (f) are deemed to be fulfilled by the use of the minimum annual premiums set out in point 3.3.

Use of single premiums in guarantee schemes for SMEs

The Commission is aware that carrying out an individual risk assessment of each borrower is a costly process, which may not be appropriate where a scheme covers a large number of small loans for which it represents a risk pooling tool.

Consequently, where a scheme only relates to guarantees for SMEs and the guaranteed amount does not exceed a threshold of EUR 2,5 million per company in that scheme, the Commission may accept, by way of derogation from point 3.4(d), a single yearly guarantee premium for all borrowers. However, in order for the guarantees granted under such a scheme to be regarded as not constituting State aid, the scheme has to remain self-financing and all the other conditions set out in points 3.4(a), (b) and (c) as well as in points 3.4(e), (f) and (g) still have to be fulfilled.

3.6. **No automatic classification as State aid**

Failure to comply with any one of the conditions set out in points 3.2 to 3.5 does not mean that the guarantee or guarantee scheme is automatically regarded as State aid. If there is any doubt as to whether a planned guarantee or guarantee scheme constitutes State aid, it should be notified to the Commission.

4. **GUARANTEES WITH AN AID ELEMENT**

4.1. **General**

Where an individual guarantee or a guarantee scheme does not comply with the market economy investor principle, it is deemed to entail State aid. The State aid element therefore needs to be quantified in order to check whether the aid may be found compatible under a specific State aid exemption. 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.

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.

When calculating the aid element in a guarantee, the Commission will devote special attention to the following elements:

(a) whether in the case of individual guarantees the borrower is in financial difficulty. Whether in the case of guarantee schemes, the eligibility criteria of the scheme provide for exclusion of such undertakings (see details in point 3.2(a)).

The Commission notes that for companies in difficulty, a market guarantor, if any, would, at the time the guarantee is granted charge a high premium given the expected rate of default. If the likelihood that the borrower will not be able to repay the loan becomes particularly high, this market rate may not exist and in exceptional circumstances the aid element of the guarantee may turn out to be as high as the amount effectively covered by that guarantee;

([19]) This includes the provision whereby for SMEs which do not have a credit history or a rating based on a balance sheet approach, the safe-harbour premium is set at 3,8 % but this can never be lower than the premium which would be applicable to the parent companies.

(b) whether the extent of each guarantee can be properly measured when it is granted.

This means that the guarantees must be linked to a specific financial transaction, for a fixed maximum amount and limited in time. In this connection the Commission considers in principle that unlimited guarantees are incompatible with Article 87 of the Treaty;

(c) whether the guarantee covers more than 80 % of each outstanding loan or other financial obligation (see details and exceptions in point 3.2(c)).

In order to ensure that the lender has a real incentive to properly assess, secure and minimise the risk arising from the lending operation, and in particular to assess properly the borrower's creditworthiness, the Commission considers that a percentage of at least 20 % not covered by a State guarantee should be carried by the lender ([20]) to properly secure its loans and to minimise the risk associated with the transaction. The Commission will therefore, in general, examine more thoroughly any guarantee or guarantee scheme covering the entirety (or nearly the entirety) of a financial transaction except if a Member State duly justifies it, for instance, by the specific nature of the transaction;

(d) 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 (see details in point 3.2(d)).

4.2. **Aid element in individual guarantees**

For an individual guarantee the cash grant equivalent of a guarantee should be calculated as the difference between the market price of the guarantee and the price actually paid.

Where the market does not provide guarantees for the type of transaction concerned, no market price for the guarantee is available. In that case, the aid element should be calculated in the same way as the grant equivalent of a soft loan, namely as the difference between the specific market interest rate this company would have borne without the guarantee and the interest rate obtained by means of the State guarantee after any premiums paid have been taken into account. If there is no market interest rate and if the Member State wishes to use the reference rate as a proxy, the Commission stresses that the conditions laid down in the communication on reference rates ([21]) are valid to calculate the aid intensity of an individual guarantee. This means that due attention must be paid to the top-up to be added to the base rate in order to take into account the relevant risk profile linked to the operation covered, the undertaking guaranteed and the collaterals provided.

4.3. **Aid element in individual guarantees for SMEs**

For SMEs, the simplified evaluation system outlined in point 3.3 can also be applied. In that case, if the premium for a given guarantee does not correspond to the value set as a minimum for its rating class, the difference between this minimum level and the premium charged will be regarded as aid. If the guarantee lasts more than a year, the yearly shortfalls are discounted using the relevant reference rate ([22]).

Only in cases clearly evidenced and duly justified by the Member State concerned may the Commission accept a deviation from these rules. A risk-based approach still has to be respected in such cases.

4.4. **Aid element in guarantee schemes**

For guarantee schemes, 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 set up in accordance with the conditions laid down in point 3.4. The aforementioned theoretical premiums from which the aid element is calculated have therefore to cover the normal risks

([20]) This is based on the assumption that the corresponding level of security is provided by the company to the State and the credit institution.
([21]) See the Communication referred to in footnote 11.
([22]) See further details in footnote 14.

associated with the guarantee as well as the administrative and capital costs ([23]). 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.

Aid elements in guarantee schemes can also be calculated through methodologies already accepted by the Commission following their notification under a regulation adopted by the Commission in the field of State aid, such as Commission Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid ([24]) or Commission Regulation (EC) No 1857/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to State aid to small and medium-sized enterprises active in the production of agricultural products and amending Regulation (EC) No 70/2001 ([25]), provided that the approved methodology explicitly addresses the type of guarantees and the type of underlying transactions at stake.

Only in cases clearly evidenced and duly justified by the Member State concerned may the Commission accept a deviation from these rules. A risk-based approach still has to be respected in such cases.

4.5. **Aid element in guarantee schemes for SMEs**

The two simplification tools outlined in point 3.5 and relating to guarantee schemes for SMEs can also be used for aid calculation purposes. The conditions of use of both rules are defined as follows:

Use of safe-harbour premiums in guarantee schemes for SMEs

For SMEs, the simplified evaluation system outlined above in point 3.5 can also be applied. In that case, if the premium for a given category in a guarantee scheme does not correspond to the value set as a minimum for its rating class ([26]), the difference between this minimum level and the premium charged will be regarded as aid ([27]). If the guarantee lasts more than a year, the yearly shortfalls are discounted using the reference rate ([28]).

Use of single premiums in guarantee schemes for SMEs

In view of the more limited distortion of competition that may be caused by State aid provided in the framework of a guarantee scheme for SMEs, the Commission considers that if an aid scheme only relates to guarantees for SMEs, where the guaranteed amount does not exceed a threshold of EUR 2,5 million per company in this given scheme, the Commission may accept, by way of derogation from point 4.4, a valuation of the aid intensity of the scheme as such, without the need to carry out a valuation for each individual guarantee or risk class within the scheme ([29]).

([23]) This calculation can be summarised, for each risk class, as the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor of the risk class ('risk' being the probability of default after inclusion of administrative and capital costs), which represents the market premium, and (b) any premium paid, i.e. (guaranteed sum × risk) – premium paid.

([24]) OJ L 302, 1.11.2006, p. 29.

([25]) OJ L 358, 16.12.2006, p. 3.

([26]) This includes the possibility whereby SMEs which do not have a credit history or a rating based on a balance sheet approach, the safe-harbour premium is set at 3,8 % but this can never be lower than the premium which would be applicable to the parent company or companies.

([27]) This calculation can be summarised, for each risk class, as the outstanding sum guaranteed multiplied by the difference between (a) the safe-harbour premium percentage of that risk class and (b) the premium percentage paid, i.e. guaranteed sum × (safe-harbour premium – premium paid).

([28]) See further details in footnote 11.

([29]) This calculation can be summarised, irrespective of the risk class, as the difference between (a) the outstanding sum guaranteed, multiplied by the risk factor of the scheme ('risk' being the probability of default after inclusion of administrative and capital costs), and (b) any premium paid, i.e. (guaranteed sum × risk) – premium paid.

5. COMPATIBILITY WITH THE COMMON MARKET OF STATE AID IN THE FORM OF GUARANTEES

5.1. General

State guarantees within the scope of Article 87(1) of the Treaty must be examined by the Commission with a view to determining whether or not they are compatible with the common market. Before such assessment of compatibility can be made, the beneficiary of the aid must be identified.

5.2. Assessment

Whether or not this aid is compatible with the common market will be examined by the Commission according to the same rules as are applied to aid measures taking other forms. The concrete criteria for the compatibility assessment have been clarified and detailed by the Commission in frameworks and guidelines concerning horizontal, regional and sectoral aid ([30]). The examination will take into account, in particular, the aid intensity, the characteristics of the beneficiaries and the objectives pursued.

5.3. Conditions

The Commission will accept guarantees only if their mobilisation is contractually linked to specific conditions which may go as far as the compulsory declaration of bankruptcy of the beneficiary undertaking, or any similar procedure. These conditions will have to be agreed between the parties when the guarantee is initially granted. In the event that a Member State wants to mobilise the guarantee under conditions other than those initially agreed to at the granting stage, then the Commission will regard the mobilisation of the guarantee as creating new aid which has to be notified under Article 88(3) of the Treaty.

6. REPORTS TO BE PRESENTED TO THE COMMISSION BY THE MEMBER STATES

In accordance with general monitoring obligations ([31]), in order to further monitor new developments on the financial markets and since the value of State guarantees is difficult to assess and changes over time, the constant review, pursuant to Article 88(1) of the Treaty, of State guarantee schemes approved by the Commission is of particular importance. Member States shall therefore submit reports to the Commission.

For aid guarantee schemes, these reports will have to be presented at least at the end of the period of validity of the guarantee scheme and for the notification of an amended scheme. The Commission may however consider it appropriate to request reports on a more frequent basis, depending on the case.

For guarantee schemes, for which the Commission has taken a non-aid decision, and especially when no solid historic data exists for the scheme, the Commission may request, when taking its non-aid decision for such reports to be presented, thereby clarifying on a case-by-case basis the frequency and the content of the reporting requirement.

Reports should include at least the following information:

(a) the number and amount of guarantees issued;

(b) the number and amount of guarantees outstanding at the end of the period;

(c) the number and value of defaulted guarantees (displayed individually) on a yearly basis;

(d) the yearly income:

1. income from the premiums charged;

2. income from recoveries;

3. other revenues (e.g. interest received on deposits or investments);

([30]) See Competition law applicable to State aid in the European Community:
http://ec.europa.eu/comm/competition/state_aid/legislation/legislation.html
For sector specific State aid legislation, see for agriculture:
http://ec.europa.eu/agriculture/stateaid/leg/index_en.htm
and for transport:
http://ec.europa.eu/dgs/energy_transport/state_aid/transport_en.htm

([31]) Such as those laid down in particular by Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 140, 30.4.2004, p. 1). Regulation as last amended by Regulation (EC) No 271/2008 (OJ L 82, 25.3.2008, p. 1).

(e) the yearly costs:

1. administrative costs;
2. indemnifications paid on mobilised guarantees;

(f) the yearly surplus or shortfall (difference between income and costs); and

(g) the accumulated surplus or shortfall since the beginning of the scheme ([32]).

For individual guarantees, the relevant information, mainly that referred to in points (d) to (g), should be similarly reported.

In all cases, the Commission draws the attention of Member States to the fact that correct reporting at a remote date presupposes correct collection of the necessary data from the beginning of the use of the scheme and their aggregation on a yearly basis.

The attention of Member States is also drawn to the fact that for non-aid guarantees provided individually or under a scheme, although no notification obligation exists, the Commission may have to verify that the guarantee or scheme does not entail aid elements, for instance following a complaint. In that case, the Commission will request information similar to that set out above for reports from the Member State concerned.

Where reports already have to be presented following specific reporting obligations established by block exemption regulations, guidelines or frameworks applicable in the State aid field, those specific reports will replace the reports to be presented under the present guarantee reporting obligation provided the information listed above is included.

7. **IMPLEMENTING MEASURES**

The Commission invites Member States to adjust their existing guarantee measures to the stipulations of the present Notice by 1 January 2010 as far as new guarantees are concerned.

([32]) If the scheme has been active for more than 10 years, only the last 10 annual amounts of shortfall or surplus are to be provided.