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STATE AID

COMMISSION ADOPTS FRAMEWORK FOR COVID-19 STATE AID

On 19 March 2020, the Commission adopted a (new) Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (the "Temporary Framework") to remedy a serious disturbance across the EU economy. The aim is to swiftly enable the Member States to provide support to companies in financial difficulty as a result of the COVID-19 outbreak under EU State aid rules. On the basis of the Temporary Framework, the Federal Government notified several State aid programmes with the Commission which were approved by the Commission in record breaking time on 22 March 2020 and 24 March 2020.

Measures under the Temporary Framework at a glance

- Aid in the form of direct grant or tax advantage
- Aid in the form of subsidised guarantees for bank loans
- Aid in the form of subsidised interest rates
- Clarification of the role of the banks as financial intermediaries
- Short-term export credit insurance

All types of aid measures have in common that they may only be granted to those companies, which were not in difficulty on 31 December 2019 but entered in difficulty thereafter as a result of the COVID-19 outbreak. They can be granted by 31 December 2020 at the latest.

Background

Most State measures adopted or notified by national governments to help ailing companies (loans, guarantees, etc.) constitute state aid. This also applies in particular in times of crisis: All state aid measures which are granted in order to combat the COVID-19 outbreak generally have to be notified to the Commission and cannot be implemented without the Commission's prior approval. This situation involves challenges for Member States, the Commission and for aid recipients.

However, the EU has done everything in its power to give the Member States the necessary flexibility under EU state aid law to reduce the economic impact of the COVID-19 outbreak. The Temporary Framework, which has been adopted in record-breaking time (just a few days), is built on the experience from the measures taken during the financial crisis in the years 2008/2009. There are significant similarities between the set rules applied in 2008/2009 (which was called also the "Temporary Framework") and the Temporary Framework adopted on 19 March 2020.

It is important to note that the Temporary Framework is not self-executing, i.e. Member States cannot base measures directly on it. If Member States want to make use of the aforementioned instruments above, they first have to adopt so called "schemes" (which are applicable) and which have to be notified to the Commission. The Commission then has to examine the compatibility of the proposed schemes with the Temporary Framework. Only after the "national scheme" has been approved by the Commission, Member States can grant individual aid immediately without the Commission's approval.

The measures possible under the Temporary Framework can go well beyond the tools previously available (i.e. the development programmes of the KfW and other development banks that were already in existence before the COVID-19 outbreak).

Direct grant or tax advantages

According to the Temporary Framework, the Member States are able to set up schemes to grant up to EUR 800.000 to a company to address its urgent liquidity needs. This can be done by way of direct grants, repayable advances, tax advantages or payments advantages.

Public guarantees on loans

One of the most important instruments under the Temporary Framework is the possibility to grant State guarantees for loans: Member States are able to grant State guarantees for loans relating to both investment and working capital loans at relatively low guarantee premiums. The guarantee must not exceed 90% of the loan principal (where losses are sustained proportionally under same conditions by the credit institution and the State) and 35% (where losses are first attributed to the State and only then to the credit institutions, i.e. a first-loss guarantee) respectively. The duration of the guarantee is limited to a maximum of six years.

In the Temporary Framework, guarantee premiums are set at a minimum level. On the basis of the maturity of the loan (1 year, 2-3 years or 4-6 years) - depending on the beneficiary of the loan (small and medium sized enterprises ("SMEs") or large enterprises) - a credit risk margin is set which ranges from 25 bps to 200 bps. However, as an alternative, Member States may notify schemes, considering these minimum levels as basis, but whereby maturity, pricing and guarantee coverage can be modulated (e.g. lower guarantee coverage offsetting a longer maturity).

Loans with a maturity beyond 31 December 2020 covered by State guarantees are limited in amount to the double of the annual wage bill of the beneficiary (including social charges as well as the cost of personnel working on the company site but formally in the payroll of subcontractors) for 2019 or 25% of the total turnover in 2019. This upper-limit can be very important given that the capital needs of some companies might exceed the annual wage bill. Only with appropriate justification and based on a self-certification by the beneficiary of its liquidity needs can, the amount of the loan be increased to cover the liquidity needs from the moment of granting for the coming 18 months for SMEs and for the coming 12 months for large enterprises. For loans with a maturity until 31 December 2020, the amount of the loan principal may be higher with appropriate justification, provided that proportionality of the aid remains assured.

Loans at preferential terms (subsidised interest rates)

Another important tool under the Temporary Framework are support measures in the form of subsidised interest rates for public loans: These loans may be granted at a reduced interest rate which, however, corresponds at least to the base interest rate applicable on 1 January 2020 plus a credit risk margin which corresponds to the minimum levels for the aforementioned State guarantees. However, as an alternative, Member States may notify schemes, considering these minimum levels as basis, but whereby maturity, pricing and guarantee coverage can be modulated (e.g. lower guarantee coverage offsetting a longer maturity).

The maximum amount of the loan which may be supposed by subsidised interest rates corresponds to that for State guarantees. The reduced interest rates may be granted for a period of six years.

Again, the loan may relate to both investment and working capital needs. Different from guarantees, there is no "90%-/35%-rule" which would limit the State exposure.

Safeguards for banks

The Temporary Framework makes clear that, if Member States decide to grant aid to the real economy via credit institutions or other financial institutions as financial intermediaries, this is direct aid to the undertakings, not to the banks themselves. The Temporary Framework additionally explains how possible indirect aid to the credit institution or other financial institutions can be prevented in order to limit undue distortions to competition and ensure that the advantages are passed on to the largest extent possible to the final beneficiaries in the form of higher volumes of financing, riskier portfolios, lower collateral requirements, lower guarantee premiums or lower interest rates.

Short-term export credit insurance

The Temporary Framework introduces additional flexibility on how to demonstrate that in certain countries cover for marketable risks could be temporarily unavailable. This enables the Member States to assume short-term export credit insurance as needed.

Measures of the Federal Government – "KfW Sonderprogramm 2020"

The Federal Government has announced a multi-billion euro aid package for loans and State guarantees. The German state-owned development bank (Kreditanstalt für Wiederaufbau - KfW) will play a key role in this.

On the basis of the Temporary Framework, the Federal Government initially notified two bundles of measures with the Commission which were approved by the Commission within a few days on 22 March 2020.
As a first step, the Federal Government, together with the KfW, introduced the "Additional KfW Special Program for the Economy" ("KfW-Sonderprogramm 2020") which comprises two elements:

- A loan programme under which KfW will cover up to 90% of the principal bank's risk of non-payment of loans to undertakings of any size, whereby the duration of the loans may be up to five years and, depending on the liquidity needs of the undertaking, may amount to up to EUR 1 billion, and
- a loan programme under which the KfW works together with private banks in order to be able to provide larger loans as a consortium. With this rule, the risk covered by the State can amount to up to 80% of a loan (but not more than 50% of the total debt volume on the undertaking's balance sheet).

The measures must generally be applied for with the principal banks and other financing partners of KfW. The loans are granted at low interest rates (between 1% and 1.46% per year for KMU or between 2% and 2.12% per year for large enterprises).

Against this background, the KfW-Sonderprogramm 2020 falls somewhat short of the instruments allowed under the Temporary Framework. This is particularly true with regard to the assumption of the non-payment risks of credit institutions and other financial institutions for large enterprises: Instead of 100% for credits which would be allowed under EU law, KfW only covers a non-payment risk for large enterprise of 80% at maximum. The limitation of the loans to a maximum of five years under the KfW-Sonderprogramm 2020 likewise falls below the possibilities under the Temporary Framework.

In addition, the Federal Government, on the basis of the Temporary Framework, notified further state aid schemes with the Commission, which were approved by the Commission on 24 March 2020:

- A Federal scheme for small grants ("Bundesregelung Kleinbeihilfen 2020") taking the form of direct grants, repayable advance or tax and payment advantages, and
- a loan guarantee scheme ("Bundesregelung Bürgschaften 2020") enabling State guarantees of up to 90% for investment and working capital loans according to the requirements of the Temporary Framework in relation to State guarantees.

What can undertakings do?

The Member States and the Commission have performed an amazing feat to stem the economic impacts of the corona pandemic on the real economy. In record time, not only Germany has set up national aid programmes, but also a great number of other Member States. The Commission, for its part, approved these programmes within a few days.

It is recommendable for companies to contact their principal bank or another financing partner of the KfW at an early stage in order to already discuss financing options and prepare required application materials in advance.

Concerning the practical application of the aforementioned rules, aid recipients have to bear in mind that Member Stats have very little flexibility in handling these rules and that there is limited room for negotiation. As far as the structure, the "pricing" as well as the terms and conditions of a state guarantee or a public loan are concerned, Member States have to comply with the requirements of the Temporary Framework and the respective national scheme. Otherwise, they risk that the measure is not in line with the scheme and the Temporary Framework, which could render the measure illegal.

Equity injections?

Along with the KfW-Sonderprogramm 2020, the Federal Government plans to adopt rules on State equity participations similar to those that were enacted during the 2008/2009 financial crisis. The draft bill provides for the creation of an unincorporated special fund ("Wirtschaftsbeteiligungsfonds" - "WSF") to buoy up the real economy which essentially corresponds to the special financial market stabilisation fund ("Sondervermögen Finanzmarktstabilisierungsfonds" (FMSA or SoFFin)) of 2008/2009. The WSF is primarily to utilise two instruments:

- Guarantees (e.g. for emissions) in order to remedy liquidity shortages and support the refinancing on the capital market, and
- Recapitalisation of undertakings, i.e. genuine equity participations or subordinated liabilities (dormant equity holdings).

Additionally, there are flanking regulations, such as remuneration regulations for management board members, the streamlining of corporate procedures for implementing capital measures, simplifying merger control, etc. The Act is supposed to be taken up by the Federal Parliament in the middle of this week and the Federal Council on 27 March 2020.

However, it should be noted: Equity injection instruments such as those provided for in the draft bill for the creation of the WSF do not fall under the Temporary Framework and would therefore require notification of the Commission, as well as an approval, in each individual case. This can be time-consuming and result in the Commission exerting influence over the specific structuring of the conditions for the capital injection.

Other options for firms in difficulties

The Temporary Framework aims to support companies, which were not in difficulty before the crisis, but entered in difficulty thereafter because of the COVID-19 outbreak. If an undertaking, however, has fundamental difficulties, the European Commission's Rescue and Restructuring Guidelines from 2014 ("the R&R Guidelines") provide a legal basis on which the EU Commission can approve state aid to firms in difficulties. There are basically two types of aid which can be authorised on this basis:

- **Rescue aid** is intended to provide (only) short term repayable finance (six months). Given the limited admissible time for the use of rescue aid, it should only consist of measures, which are easily reversible, like a loan or a guarantee.
- **Restructuring aid** provides a long term injection of finance at non-normal market conditions. The Commission approves restructuring aid only if it is (a) based on a comprehensive restructuring plan, (b) the aid is kept to the minimum necessary while the aid recipient provides an "own contribution", and (c) any distortions of competition resulting from the aid are "compensated" by measures of the firm concerned (divestments and other measures)

The R&R track is, of course, more onerous, painful and time-consuming than the "quick-fix" solutions under the Temporary Framework.

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